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STATE TAXATION OF ENERGY RESOURCES: AFFIRMATION OF *COMMONWEALTH EDISON COMPANY V. MONTANA*

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I. INTRODUCTION

A decade ago, Colstrip Montana was a close-knit ranching community of 200 people.[1] The town suffered from economic stagnation and the regional emigration of its youth, as it lay sleepily upon the nation's richest coal reserves.[2] Colstrip's quiet existence changed radically in the early 1970's when the OPEC oil embargo resulted in a renewed national focus on the development of domestic coal reserves. Within one year Colstrip's population exploded to 2,000 people to meet the manpower needs of the coal industry.[3] The town's present population of 5,500[4] requires expanded and expensive public services — new schools, increased hospital facilities, upgraded roads, sufficient housing, and an expanded water supply — all to be provided by the state and local governments.[5] Colstrip is but one of the many western towns directly affected by the increased national demand for coal.

Many of the residents of the energy producing states of the West and South perceive themselves as victims of colonial exploitation,[6]

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1. *Coal Severance Tax: Hearing on S. 2695 before the Senate Committee on Energy and Natural Resources*, 96th Cong., 2d Sess. 340, 341 (Aug. 6, 1980) (statement of Mont. State Sen. Thomas E. Towe). [Hereinafter cited as *Coal Severance Tax Hearing*].
2. Western Energy Company Factsheet on Colstrip, Montana (1981).
3. Conversation with Bill Schwarzkoph, Reclamation Supervisor, Western Energy Company, Colstrip, Montana (Jan. 8, 1982).
4. *Id.*
5. *Coal Severance Tax Hearing, supra* note 1, at 141 (statement of Wyo. U.S. Sen. Malcolm Wallop).
6. These states include Montana, Wyoming, North Dakota, and Louisiana. *Federal Pre-*

and feel that the unique environmental and social characteristics of their energy-rich areas are being sacrificed to the nation's energy demands.[7] As a result, these states are turning to the legislative process to develop revenue measures designed to compensate them for the significant costs of resource development.[8] Many state legislatures have enacted or presently are enacting taxes on energy resource production activities within their borders.[9] These energy resource taxes are in fact generating tremendous revenues. The four largest energy-producing states — California, Alaska, Louisiana, and Texas — are expected to receive over $100 billion from resource development revenues during the 1980's.[10] With these incoming riches, the energy-producing states are able to increase public services, lower their income tax and property tax rates, and attract industry to their more favorable economic environments.

Twenty-five hundred miles away from Colstrip, Montana, the fragmented industrial cities of the Northeast and Midwest[11] are facing extremely difficult financial and social problems. Confronted with the possibility of bankruptcy, many of these cities have averted financial disaster only by enacting heavy tax increases combined with drastic service cuts and worker layoffs.[12] These urban areas are centers of unemployment and unrest; yet they must pay much more for the same amount of energy than consumers in other parts of the country — in some cases up to 97 percent more.[13] Understandably,

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emption of State Energy Policies: Hearings before the Subcomm. on Limitations of Contracted and Delegated Authority of the Senate Comm. on the Judiciary, 96th Cong., 2d Sess. 45 (Oct. 14 and 20, 1980) (statement of Mont. State Sen. Thomas E. Towe); *id.* at 58 (statement of North Dakota Att'y Gen. Allen I. Olson) [hereinafter cited as *Federal Preemption of State Energy Policies Hearings*].

7. *Id.* at 143 (App., paper of Prof. Daniel H. Henning).

8. *See infra* text at notes 148-84.

9. Colorado (1978) and North Dakota (1977) enacted severance taxes on coal; Montana (1975) and New Mexico (1977) revised their coal severance tax rates. Church, *Conflicting Federal, State and Local Interest Trends in State and Local Energy Taxation,* 31 NAT'L TAX. J. 269, 271 (1978); *Commerce Clause and the Severance Tax: Hearings on Fiscal Disparities before the Subcomm. on Intergovernmental Relations of the Senate Comm. on Governmental Affairs,* 97th Cong., 1st Sess. 108 (July 15-16, 1981) (statement of Shirley Kallek, Bureau of the Census). [Hereinafter cited as *Commerce Clause Hearings*] (Note: pagination is to unofficial copy of Hearings).

10. *Coal Severance Tax Hearing, supra* note 1, at 107 (citing Minneapolis Star, May 12, 1980).

11. Such cities include New York City, Boston, Cleveland, Chicago, Buffalo, Philadelphia, and Washington, D.C. *See Coal Severance Tax Hearing, supra* note 1, at 94 (citing Washington Post, Apr. 20, 1980).

12. *Id.*

13. *Coal Severance Tax Hearing, supra* note 1, at 97 (citing U.S. News & World Report, June 16, 1980).

these states are complaining about the economic burden placed upon them by the energy resource taxation of the producing states. Fearing domestic cartelization of the energy resource market, the energy-importing states of the North and East are forming coalitions to fight for a larger share of the nation's energy wealth.[14]

Conflict has arisen over the taxes levied by energy-producing states which ultimately must be paid by residents of energy-importing states.[15] Not only a newsworthy topic of public interest,[16] this conflict also poses an important legal question of constitutional federalism:[17] the extent to which a state's authority to tax must be balanced with federal interests in implementing cohesive national energy policies.[18] Present federal energy policy includes a commitment to increase coal consumption in order to decrease dependence on foreign energy supplies.[19] Difficulties arise in attempting to weigh the need for a state's coal severance tax against the need for a national energy policy.[20]

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14. *Id.*

15. *See infra* text at notes 53-65.

16. *See Coal Severance Tax Hearing, supra* note 1, at 94-112.

17. The Constitution's Commerce Clause grants to Congress the power "to regulate commerce . . . among the several states." U.S. CONST. art. I, § 8, cl. 3. It was adopted to overcome interstate rivalries and territorial protection of local economic interests. Browde & DuMars, *State Taxation of Natural Resource Extraction and the Commerce Clause: Federalism's Modern Frontier,* 60 OR. L. REV. 7 (1981). This grant of authority provides the necessary federal regulatory power to free national commerce from acts of economic retribution by competing states. Accompanying the positive grant of federal regulatory authority is the negative implication that states may not invade that special federal province. A flexible balancing approach between federal and state commercial interests has been the hallmark of commerce clause adjudication. *See generally* L. TRIBE, AMERICAN CONSTITUTIONAL LAW §§ 5-7, 5-8 (1978).

18. Inherent in the form of federalism created by the Constitution, federal-state tensions are especially manifest in the state sovereignty evidenced by that very state power. The tenth amendment is viewed as a check on congressional commerce clause powers. "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. CONST. amend. X.

The Supreme Court in Nat'l League of Cities v. Usery, 426 U.S. 833 (1976) stated: "Congress may not exercise [its Commerce Clause power] so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made." *Id.* at 855. The taxing authority exercised by a state is an integral governmental function, both because the state depends upon the power to tax for its economic viability and because the taxing power is a legitimate function of the state as an autonomous entity. See Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 10 (1824).

19. *See infra* text at notes 229-38.

20. The decision in *Nat'l League of Cities v. Usery* traditionally has given strength to tenth amendment claims of legitimate exercise of state powers, but it should be remembered that the Court's majority holding in this case was the result of a swing vote by Justice Blackmun. *See* 426 U.S. 833, 856 (1976) (Blackmun, J., concurring). His framing of the issue was not based on whether the federal action interferred with state and local decisionmaking; rather, the issue was only whether there is a balance that should be weighed in favor of federal or

A coal severance tax is a privilege tax which is due when the coal is extracted, or "severed" from the ground.[21] The rate of the tax is based either on the market value or quantity of the coal removed or sold.[22] The tax is paid most often by the producer of the coal.[23] Most coal producers operate under the provisions of long-term contracts with electric utilities which specify the amounts and qualities of the coal to be produced.[24] These long-term supply contracts require the utilities to pay the producers' costs, including state-levied taxes. The impact of a state's coal severance tax is, thus, passed on to the utility.[25] In turn, most electric utilities are publicly regulated and, as such, are allowed to pass through their increased costs to the utility consumer — the individual who is heating, cooling, and lighting his home. This consumer, most often residing in a state other than where the coal is produced, ultimately pays a coal severance tax.[26]

Amid the complex and competing economic, sociological, and political clamor over state taxation of energy resources, the Supreme Court heard the case of *Commonwealth Edison Company v. Montana.*[27] The contest concerned the legitimacy of Montana's 30 percent tax on the extraction of coal.[28] In spite of assertions by coal producers and utilities that the rate of the tax inhibited interstate commerce, the state's coal severance tax was upheld.[29] The Court declined to fashion a legal test which would determine the appropriateness of resource taxation rates. As a result, the decision in *Commonwealth Edison* leaves a persistent and unresolved question: who should decide the appropriate level of energy resource taxation — the state legislatures or the United States Congress?

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state regulations. *Id. Accord, Federal Preemption of State Energy Policies Hearings, supra* note 6, at 111 (statement of Prof. Jan Laitos).

21. [1979] 2 STATE TAX GUIDE (CCH) ¶ 45-000.

22. *See infra* text at notes 48-52.

23. [1979] 2 STATE TAX GUIDE (CCH) ¶ 45-000. A few states provide that payment of the severance tax is to be made by the first purchaser, unless the product is not sold within a specified period following severance, in which case the tax is to be paid by the producer. Statutes may provide that acts necessary to separate, refine or finish a product are considered part of the production, and if carried on by more than one person, the tax will be allocated to the value of the product in each stage. *Id.*

24. DEPARTMENT OF ENERGY, COAL COMPETITION PROSPECTS FOR THE 1980's, 46 Fed. Reg. 10,686-10,704 (1981) [hereinafter cited as COAL COMPETITION].

25. *Id.* at 10,700.

26. *See* Appellant's Complaint ¶ 17-18 (No. 80-581, filed Oct. 1980), Commonwealth Edison Company v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS (BNA) 13 Tax Series 9, at 97-98 (1981) [hereinafter cited as LAW REPRINTS]. *See infra* text at notes 53-65.

27. 453 U.S. 609 (1981).

28. MONT. REV. CODE ANN. § 17-35-101-11 (1981).

29. 453 U.S. 609 (1981).

This article will address the troublesome topic of state taxation of energy resources, with a focus on coal severance taxes.[30] First, the recent case of *Commonwealth Edison* will be considered. The issues and arguments will be presented as well as the decisions of the Montana Courts and the United States Supreme Court. Second, the proper decisionmaking forum for fashioning an equitable resource tax will be analyzed. The state legislature's unique closeness to the actual costs involved in resource development at the state and local levels will be examined as well as the rationales for enactment of a severance tax in particular. Congress' interest in a cohesive and workable national energy policy will also be examined, primarily in light of the federal government's unclear enunciation of a national coal policy and the inefficient management of coal development to date. Finally, alternatives to the current development of the gross fiscal disparities between energy-producing and energy-importing states will be proposed.

II. *COMMONWEALTH EDISON COMPANY V. MONTANA*

A. The Underlying Issues

The Montana coal severance tax rate of 30 percent of market value is the highest energy resource severance tax in the nation.[31] The midwestern utilities which purchase the major portion of Montana coal pay the severance tax and then pass on their costs to individual consumers.[32] Those consumers bear the burden of a tax upon which they have no vote.[33] Both the rate of the Montana coal severance tax and who must pay that tax were key issues in the case of *Commonwealth Edison Company v. Montana*.[34] The Supreme Court, however, refused to apply an explicit standard of review to either

30. As discussed in this article, state taxation of energy resources includes a variety of tax measures; however, focus will be given to severance taxes imposed on the extraction of energy resources. Particular attention will be paid to the taxation of coal, specifically the Montana coal severance tax. *See generally* Browde and DuMars, *supra* note 17; Hellerstein, *Constitutional Constraints on State and Local Taxation of Energy Resources,* 31 NAT'L TAX J. 245 (1978); Parnell, *Constitutional Considerations of Federal Control over the Sovereign Taxing Authority of the States,* 28 CATH. U.L. REV. 227 (1979); Bassett, *Constitutional Limitations on State Severance Taxes,* 20 NAT. RESOURCES J. 887 (1980).

31. *Coal Severance Tax Hearing, supra* note 1, at 86 (citing Energy: Limiting State Coal Severance Taxes, Report by the Congressional Research Service (1980)).

32. Commonwealth Edison Co. v. Montana, 453 U.S. 609, 619-20 & n.8 (1981); Jurisdictional Statement of Appellees at 4, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 18.

33. *Id.* Ninety percent of the value of Montana's entire coal production was shipped out-of-state. *Id.*

34. 453 U.S. 609, 617-624 (1981).

issue. The Court stated that severance tax rates are to be determined by the state legislatures, unless those rates act contrary to federal interests.[35] The Court went on to say that the consumers of electricity generated by Montana coal should pay for the benefits which they receive from Montana.[36] The following discussion, which introduces the Montana coal severance tax and explores the manner in which it is "exported" to residents of other states, provides the background necessary to an understanding of the arguments and decisions in the *Commonwealth Edison* case.

1. The Tax

As a result of the 1973 OPEC oil embargo, the nation looked to the development of huge coal reserves held by the Western states[37] as an answer to its energy dilemma. The Montana state legislature recognized the coal industry's increasing impact and demands upon the state and, in 1974, appointed an interim subcommittee to study the existing state tax structure and recommend changes.[38] At that time, the state's revenue system included a tax on the net proceeds of all mining activities,[39] a resource indemnity trust tax,[40] a mining license tax,[41] and property taxes on mining equipment.[42] The subcommittee recommended revision of two aspects of Montana's taxation of coal production. The mining license tax, a severance tax measured as a percentage of the quantity of the coal extracted, was to be revised to reflect not only the quantity but also the quality of the coal produced.[43] The net proceeds tax was, at the time, a levy on

35. *Id.* at 624-25, 628.

36. *Id.* at 622-23.

37. This coal-rich area in the Northern Great Plains region encompasses eastern portions of Montana and Wyoming and western sections of North Dakota. *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 129 (App., paper of Prof. Daniel H. Henning).

38. Three resolutions, HR. 45, 63 and SR. 83, were passed in the 1974 Montana state legislature which recognized the coal industry's increasingly important role in the state and established the interim subcommittee of the Taxation Committee.

39. *See* 1974 MONT. LAWS 1619-1620, 1653-54, 1683-84 (Mar. 14 & 16, 1974). MONT. CODE ANN. § 15-23-501 (1981).

40. MONT. CODE ANN. § 15-38-104 (1981) levies a tax on mineral production at the rate of 1/2 of 1 percent of gross value at the time of extraction. MONT. CODE ANN. § 15-38-106(2) (1981) then provides for deposit of those funds in a resource indemnity trust account.

41. MONT. CODE ANN. § 15-31-101 (1981) and its subsection 121(1) provide for a mining license tax of 6 3/4 percent of all net income. In addition, MONT. CODE ANN. § 15-58-102 (1981) establishes a license tax to retail coal which is levied at the rate of 5 cents per ton.

42. MONT. CODE ANN. § 15-6-138(1)(b) (1981) taxes mining machinery at 11 percent of its market value. MONT. CODE ANN. § 15-6-140(1)(d) (1981) taxes coal haulers at 16 percent of value.

43. MONTANA COAL COUNCIL REPORT: DEVELOPMENT OF MONTANA'S 30% SEVERANCE TAX 1

all mining activities, providing deductions for certain production costs. The subcommittee suggested enactment of a gross proceeds tax on the coal mining industry in particular, allowing no deductions for production costs and providing the state with revenues needed to meet the financial demands associated with coal development.[44] These two tax reforms were enacted by the Montana state legislature in 1975.[45]

Opponents of the Montana coal severance tax accuse the state of taking advantage of its favorable energy position and its coal customers. Montana, however, had a severance tax in place before the increased production began in the early 1970's.[46] Furthermore, the state legislature reviewed the proposed tax reforms carefully and observed:

> [i]n the level of the tax, the conference committee looked at the needs to be met. The objectives were to (a) preserve or modestly increase revenues going to the general fund, (b) to respond to current social impacts attributable to coal development, and (c) to invest in the future when new energy technologies reduce our dependence on coal and mining activities may decline. The conference concluded that a severance tax of 20% on low-grade lignite and 30% on other coal, plus a gross proceeds tax running around 4-5% on all coal was necessary and equitable.[47]

The state has not imposed the tax to exploit the consumers of other states at a time of increased coal demand.

The present Montana coal severance tax is computed on factors of value, energy content, and method of extraction of the coal produced.[48] The value of the coal is determined by the contract sales price which is defined as the "price of coal extracted and prepared for shipment f.o.b. (free on board) mine, excluding that amount

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(prepared for informational use by James D. Mockler) (1981) [hereinafter cited as MONTANA COAL COUNCIL REPORT].

44. *Id.*

45. The 1975 Montana legislature actually considered two basic severance tax bills — HB 115 and SB 13. The two bills were comparable except the Senate proposed a tax of 25 percent of the coal's value and the House proposed a tax of 20 percent of value less production taxes. Following passage by the respective houses, conference committees were appointed to work out the differences. The conference committee bill was adopted in 1975. *Id.* at 2. *See* MONT. CODE ANN. § 15-35-103 (1981).

46. *See supra* note 9.

47. REPORT OF THE MONTANA FREE JOINT CONFERENCE COMM. ON COAL TAXATION 1 (1975).

48. MONT. CODE ANN. § 15-35-103 (1981).

The Montana coal severance tax provision is set forth below:

charged by the seller to pay taxes paid on production."[49] The tax is levied upon coal producers mining coal in the state of Montana. These producers generally operate under the provisions of long-term supply contracts with the purchasers of the coal. The contract sales price reflects the heating quality of the coal as well as its method of extraction. In addition, the price includes any taxes paid by the producers in order to mine the coal.

The rate of the tax is progressive, increasing with the increased BTU[50] output of each pound of coal.[51] The rate varies based on whether an underground mining or surface mining procedure is used, ranging from 3 to 4 percent of the value of underground mined coal to 20 to 30 percent of the value of surface mined coal. The tax reflects the premium cost to the state of high quality surface strip-mined coal.[52]

Severance tax — rates imposed — exemptions.

(1) A severance tax is imposed on each ton of coal produced in the state in accordance with the following schedule:

Heating quality (BTU per pound of coal)	Surface Mining	Underground Mining
Under 7,000	12 cents or 20% of value	5 cents or 3% of value
7,000-8,000	22 cents or 30% of value	8 cents or 4% of value
8,000-9,000	34 cents or 30% of value	10 cents or 4% of value
Over 9,000	40 cents or 30% of value	12 cents or 4% of value

"Value" means the contract sales price.

(2) The formula which yields the greater amount of tax in a particular case shall be used at each point on this schedule.

(3) A person is not liable for any severance tax upon 20,000 tons of the coal he produces in a calendar year.

Id.

49. MONT. CODE ANN. § 15-35-102(1) (1981). In an f.o.b., free on board, contract the seller must get the goods to the point named in the contract at his own expense and risk. *See* U.C.C. § 2-319(1); J. CALAMARI & J. PERILLO, CONTRACTS 511 n.4 (2d ed. 1977).

50. A BTU is a British thermal unit which is the quantity of heat required to raise the temperature of one pound of water by one degree Fahrenheit. Analysis of state energy taxation should be in terms of amounts paid per BTU — the comparison of tax rates alone is useless unless one also knows how much energy a particular commodity will produce. *See Federal Preemption of State Energy Policies Hearings, supra* note 6, at 78 (statement of Mont. Att'y Gen. Mike Greely).

51. *See supra* note 48.

52. Surface mining is not encouraged by the state because of the significant disruption to the environment. For a discussion of reclamation requirements, see *infra* text and notes at notes 165-71.

2. Exporting the Tax

Montana's coal severance tax is fiercely challenged because its burden is ultimately borne by out-of-state utility consumers. The practical economic scheme of the utilities' use of coal are responsible for this outcome. Severance taxes are usually paid directly by the severor or producer of the resource.[53] The long-term supply contracts between producers and utility company purchasers reflect coal production costs. Prior to the recent increase in coal development, these contracts set fixed prices for a specified range of coal quality and were rarely renegotiated. Supply contracts now provide for frequent adjustments to account for tax and price increases.[54] Consequently, these cost increases, paid directly by the coal producers and indirectly by the utility company purchasers, are passed through to the utility's consumer via automatic fuel adjustment charges.[55]

The question of who actually pays the tax is an important tax policy issue.[56] A state may structure a portion of its tax system to shift the burden of payment to fall upon out-of-state consumers of goods produced in state. When out-of-state consumers bear the tax burden it is in effect "exported."[57] The exportation of state taxes is a well-known practice in public finance and is important to most states' fiscal systems.[58] For example, Nevada exports a substantial portion of its taxes in the form of gambling taxes; Delaware does the same with its corporate franchise tax; as does Michigan with a production tax on automobiles; Florida with a sales tax geared to raise revenue from tourists; North Carolina from tobacco; California from produce and vineyards; and New York from its stock exchange

53. *See supra* text and note at note 23.

54. Church, *supra* note 9, at 270.

55. *Id. Coal Severance Tax Hearing, supra* note 1, at 18 (statement of Wyo. U.S. Sen. Alan K. Simpson).

Both New York and Connecticut have attempted to disallow the pass-through of increased energy resource costs to individual consumers. This anti-pass-through legislation was struck down by the courts, which found preemption by the Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §§ 751-760h (1976), and regulations adopted thereunder, 10 C.F.R. § 212.83(c)(2)(iii)(E)(7) (1981), which permit the pass-through of increased costs and which prohibit any price control or regulation. *See* Mobil Oil Corp. v. Tully, 639 F.2d 912 (2d Cir. 1981); Mobil Oil Corp. v. Dubro, 639 F.2d 919 (2d Cir. 1981).

56. *See* D. PHARES, STATE-LOCAL TAX EQUITY: AN EMPIRICAL ANALYSIS OF THE FIFTY STATES 7-17 (1973).

57. Church, *supra* note 9, at 276.

58. *Coal Severance Tax Hearing, supra* note 1, at 19 (statement of Wyo. U.S. Sen. Alan K. Simpson); D. PHARES, *supra* note 56, at 34, 39.

transactions.[59] Not surprisingly, strong political incentives exist for state legislatures to shift taxes to voters in other states.

Severance taxes are more amenable to exportation than certain other types of tax because the resource which is taxed is itself exported. Despite the exportability of coal, the automatic adjustment in coal supply contracts to reflect tax and price increases combines with the immobility and longevity of the mine itself to lock in the current purchaser utility to bear the tax burden.[60] As a result, the Montana severance tax is challenged as an unfair exaction from those states which rely on Montana coal.

As a practical matter, the tax burden borne by the consumers of electric utilities fueled by Montana coal is extremely light. The burden placed on these consumers by their own states in the form of sales taxes on the consumption of electricity far exceeds the cost of a severance tax.[61] Moreover, a severance tax is a miniscule part of the final cost of coal. The total price must include mining costs, reclamation costs, surface owner payments, landowners' royalties, black lung insurance, abandoned mine and reclamation fund charges, bonding costs, federal withholding and corporate income taxes, workmen's compensation, federal unemployment taxes, union pension benefits, union wages, construction of the resource-producing facility, rail transportation charges, and, of course, a reasonable

59. *Coal Severance Tax Hearing, supra* note 1, at 142, 153, 154 (statement of Wyo. U.S. Rep. Dick Cheney).

60. Church, *supra* note 9, at 277. McLure, *Economic Constraints on State and Local Taxation of Energy Resources,* 31 NAT'L TAX J. 257-259 (1978). Because exportation of tax burdens requires market dominance, with market substitutions unavailable, production sites immobile, and a centralized market structure, some commentators conclude that energy resource taxes are not effectively exported and that the owners of the capital and resources pay for the tax. *Id.*

61. In 1979, each Midwestern utilities consumer's bill reflected an annual cost to pay the Montana severance tax of between $0.78 to $4.07. That consumer also was required to pay the local taxes levied on consumption which ranged from $8.10 to $26.64. *Coal Severance Tax Hearing, supra* note 1, at 48 (recorded statement of N.M. U.S. Sen. Pete Domenici); *id.* at 135-36 (statement of Mont. U.S. Sen. John Melcher, Attachment # 3); *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 77, 78 (statement of Mont. Att'y Gen. Mike Greely). In addition, Montana's coal severance tax is completely within the range of taxes imposed by other states when expressed in dollars per million BTUs. Consider the following:

Taxes on Texas oil	yield	8.84 cents per million BTUs
Montana coal	yield	9.97 cents per million BTUs
New Mexico oil	yield	10.76 cents per million BTUs
Oklahoma oil	yield	12.58 cents per million BTUs
Louisiana oil	yield	16.58 cents per million BTUs

Coal Severance Tax Hearing, supra note 1, at 138 (statement of Mont. U.S. Sen. John Melcher, Attachment # 5).

return on investment.[62] The cost of Montana's coal severance tax to the midwestern utility consumers is negligible.

Although coal severance taxes are a small portion of a utility consumer's bill, the argument remains that, unprotected by suffrage, those consumers bear an unfair burden. Without a voice in the level or operation of the tax, they claim that it is unjust. In order to protect their consumers' interests and to protest the rate of the tax, four coal producers[63] and eleven utility company purchasers[64] filed suit against Montana in state court,[65] challenging the coal severance tax.

B. The Arguments

In 1978, a suit challenging the Montana coal severance tax was brought in the Montana State District Court. Contesting the constitutional validity of the tax, the plaintiff producers and utilities sought refunds of taxes, paid under protest, amounting to over $5.4 million. They contended that the tax was invalid under both the commerce[66] and supremacy clauses[67] of the United States Constitution.

The producers and utilities argued that the Montana tax unlawfully conflicts with the commerce clause by discriminating against in-

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Moreover, on a BTU comparison, the cost of western coal including severance taxes is almost half the cost of Appalachian coal. In 1978, the average production costs for steam coal, expressed on a cents per million BTU basis, were 95 cents for Kentucky coal and 37 cents for Montana coal. *Coal Severance Tax Hearing, supra* note 1, at 22 (statement of Wyo. U.S. Sen. Alan K. Simpson); *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 78 (statement of Mont. Att'y Gen. Mike Greely).

62. *Coal Severance Tax Hearing, supra* note 1, at 13-14 (statement of Wyo. U.S. Sen. Alan K. Simpson).

63. The four Montana coal producers were Decker Coal Company, Peabody Coal Company, Westmoreland Resources, Inc., and Western Energy Company.

64. The eleven public utility companies were Commonwealth Edison Company, Central Illinois Light Company, Dairyland Power Cooperative, Detroit Edison Company, Interstate Power Company, Lake Superior District Power Company, Lower Colorado River Authority/City of Austin, Minnesota Power and Light Company, Northern States Power Company, Upper Peninsula Generating Company, and Wisconsin Power and Light Company. These utility company consumers reside in Illinois, Iowa, Minnesota, Wisconsin, Michigan, Texas, North Dakota, and South Dakota. Appellant's Complaint ¶¶ 12.1-12.11, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 94-95.

65. It is interesting to note that a federal statute, 28 U.S.C. § 1341 (1976), forced the severance tax contest to be brought in the state court where the tax was imposed. State courts may be more favorably inclined to the state's position, and the tactics of motions to dismiss for failure to state a claim upon which relief can be granted and motions for summary judgment are easily employed. The Montana District Court granted the state's motion to dismiss and, consequently, a full factual record was never developed. *See* Bassett, *supra* note 30, at 910-11.

66. *See supra,* notes 17-18; *infra,* note 210.

67. U.S. CONST. art. VI, cl. 2. *See infra* text at note 83.

terstate commerce in its imposition of an excessive burden on out-of-state utility consumers. They contended that proper commerce clause analysis would address the practical effects of the tax and would balance the costs actually incurred by the state with the costs to the utility consumer.[68] Under this balancing test, the tax was challenged as producing revenues not fairly related to the services provided by the Montana state government.

Judicial review of state taxation of energy resources first began in the 1920's. The Supreme Court decided three such cases, known as the *Heisler* trilogy,[69] by applying a mechanical commerce clause test which examined whether the taxed activity was considered to be "in commerce" or to have "preceded commerce."[70] In each of the three

68. The producers and utilities advocated use of a balancing test to determine whether the severance tax was valid under the commerce clause. The test, which was formulated in the U.S. Supreme Court decision of Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), upholds a tax if it "is not discriminatory and is properly apportioned to local activities within the State forming a sufficient nexus to support the tax." *Id.* at 285. That test was recently applied by the Court in Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980), to determine whether the tax "is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id.* at 228. The producers and utilities were contending that the last prong of the test was not met by the Montana coal severance tax.

69. Hope Natural Gas Co. v. Hall, 274 U.S. 284 (1927) (privilege tax on natural gas production in West Virginia); Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923) (occupation tax on iron ore and other mining business in Minnesota); Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922) (production tax on anthracite coal mined in Pennsylvania).

70. The mere fact that a state product was destined to be shipped out of state would not invalidate a tax which was levied on commercial activities within the state's borders. The Court stated its concerns about state taxation of commercial activities in the early case of Coe v. Errol, 116 U.S. 517 (1886).

> It seems to us untenable to hold that a crop or a herd is exempt from taxation merely because it is, by its owner, intended for exportation. If such were the rule in many States there would be nothing but the lands and real estate to bear the taxes. Some of the Western States produce very little except wheat and corn, most of which is intended for export; and so of cotton in the Southern States. Certainly, as long as these products are on the lands which produce them, they are part of the general property of the State. And so we think they continue to be until they have entered upon their final journey for leaving the State and going into another State.

Id. at 527-28.

The *Heisler* Court was equally concerned about the effects of placing in-state production activities under commerce clause scrutiny:

> It would nationalize all industries, it would nationalize and withdraw from state jurisdiction and deliver to federal commercial control the fruits of California and the South, the wheat of the West and its meats, the cotton of the South, the shoes of Massachusetts and the woolen industries of other States, at the very inception of their production or growth, that is, the fruits unpicked, the cotton and wheat ungathered, hides and flesh of cattle yet "on the hoof," wool yet unshorn, and coal yet unmined, because they are in varying percentages destined for and surely to be exported to States other than those of their production.

260 U.S. 245, 259-260 (1922).

cases, the Court held that the act of extracting minerals precedes the entrance of those minerals into the flow of interstate commerce. No further inquiry into the practical effects of the tax was deemed relevant because no actual participation in interstate commerce had been found.[71] The imposition of a state severance tax was upheld against a commerce clause challenge in each case.

In challenging the Montana severance tax the producers and utilities tried to distinguish the *Heisler* decisions by arguing that the correct commerce clause analysis was developed by the Supreme Court in another line of cases under *Complete Auto Transit, Inc. v. Brady.*[72] There, the Court adopted a more flexible approach, focusing on the practical effect of the challenged tax rather than whether the taxed activity was or was not "in commerce." The Court held that a state tax does not offend the commerce clause if it "is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to services provided by the state."[73] The producers and utilities contended that the Montana tax does discriminate against interstate commerce and is not fairly related to services provided by the state.[74] Thus, the tax violates the commerce clause under the test formulated in *Complete Auto Transit.* In addition to the commerce clause claim, the petitioners argued that the Montana coal severance tax conflicts with the supremacy clause because the levy in effect decreases coal development by increasing prices.[75] Their first contention on the supremacy clause challenge was that the Montana tax improperly reduces revenues received by the federal government from federal lands leasing, thereby frustrating the statutory division of revenues established in the Mineral Lands Leasing Act of 1920.[76] That Act developed a system of sharing with the states the revenues received by the federal government from its leasing of public mineral lands.[77] The producers and utilities charged Montana with altering that balance by receiving revenues from

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71. *See* Browde & DuMars, *supra* note 17, at 18-21.

72. 430 U.S. 274 (1977) (upholding a privilege tax on motor carriers). *See supra* note 68.

73. 430 U.S. 274, 279 (1977).

74. *See* Appellant's Jurisdictional Statement at 20-22, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 34-36.

75. *See* Appellant's Jurisdictional Statement at 25-26, Commonwealth v. Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 39-40.

76. 30 U.S.C. §§ 181-209 (1976 & Supp. III 1979). *See* Appellant's Complaint ¶¶ 42-44, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 103.

77. 30 U.S.C. § 191 (1976).

severance taxes as well. They argued further that the supremacy clause is at issue in the conflict between federal energy policies which encourage the use and production of coal and the Montana coal severance tax which increases the cost of coal. The producers and utilities' supremacy clause position thus focused on the practical effect of the severance tax: the frustration of federal law.[78]

Countering these constitutional challenges, the state of Montana argued that the coal severance tax is a valid exercise of state authority and any intrusion into its tax-structuring policies would be a gross violation of basic constitutional federalism.[79] Montana refuted the commerce clause challenge on the ground that there is, in fact, no discrimination in the operation of the tax — it is levied on every ton of coal extracted in the state regardless of who produced it or where it is marketed.[80] The state further argued that it had a legitimate and significant interest in requiring interstate business to pay its fair share of the costs of state government.[81] Montana noted that the tax is levied only on the coal industry and that the revenues are used to defray the costs incident to that industry's activities. Hence, the tax complies with the tests established in both the *Heisler* trilogy and in *Complete Auto Transit* to evaluate an alleged violation of the commerce clause.

Addressing the supremacy clause challenge, Montana argued that the tax cannot be preempted merely because the tax imposes increased costs on congressionally encouraged activity. Montana also argued that the tax cannot be in conflict with the Mineral Lands Leasing Act of 1920 because the terms of the statute explicitly allow state severance taxes to be imposed on the output of federal mines.[82] The state maintained its position that findings of preemption must be predicated upon specific rights and regulatory schemes enacted by Congress; that general statements of policy do not constitute substantive law protected by the supremacy clause.[83] Indeed, Montana argued that federal legislation recognizes the existence of state severance taxes on coal and acknowledges the continued use of such

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78. *See* Appellant's Jurisdictional Statement at 22-24, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 36-38.

79. *See* Brief of Appellees at 44-45, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 492-93.

80. *See supra* note 48.

81. *See* Brief of Appellees at 22-29, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 470-77.

82. 30 U.S.C. § 189 (1976).

83. Usual principles of preemption analysis require an express, intentional usurpation of state regulatory authority by Congress. *See* L. TRIBE, *supra* note 17, at 391-400.

taxes.[84] According to Montana, the petitioner's supremacy clause argument was, therefore, unsupportable.

Finally, the state suggested judicial restraint in such a controversy over state taxing power, noting that Congress was already fully involved in the conflict.[85] The state argued further that only a legislative body is capable of adequately addressing the various considerations necessary to determine a severance tax rate. Thus, Montana argued, as a practical matter, the state is the appropriate entity to administer this tax.

C. The Court Decisions

1. The Montana State Courts

The Montana District Court dismissed the action brought by the coal producers and electric utilities, thereby upholding the Montana coal severance tax. The court first addressed the commerce clause issue by meticulously reviewing prior Supreme Court holdings regarding state regulation of commercial activities.[86] The Montana court applied the so-called "mechanical test" of the *Heisler* trilogy[87] and held that the extraction of coal preceded its entrance into interstate commerce. The court concluded that the tax did not offend the commerce clause and was valid on its face — no factfinding on this issue was required.

The Montana District Court next addressed the supremacy clause issue. It upheld the state's position that a direct conflict must exist before a federal statute preempts a state enactment.[88] According to the court, allegations of substantial frustration of national policies

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84. *See* Powerplant and Industrial Fuel Use Act of 1978, 42 U.S.C. § 8401(a)(2) (1976 & Supp. III 1979).

85. *See* Brief of Appellees at 33-34, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 481-82.

86. The Montana District Court cited Supreme Court holdings in the area of state taxation of commercial activities from 1922 to 1979. LAW REPRINTS, *supra* note 26, at 216-40 (unreported opinion).

87. *See supra* text at notes 60-61. The Supreme Court, in Oliver Mining Co. v. Lord, 262 U.S. 172 (1923), had stated: "Mining is not interstate commerce, but, like manufacturing, is a local business subject to local regulation and taxation." *Id.* at 178.

88. LAW REPRINTS, *supra* note 26, at 245. (unreported opinion). The Montana District Court cited the Supreme Court decision of Farmers Education & Cooperative Union v. W. Day, Inc., 360 U.S. 525 (1959) which held: "States should not be held to have been ousted from power traditionally held in the absence of either a clear declaration by Congress that it intends to forbid the continued functioning of the state law or an obvious and unavoidable conflict between the federal and state directives." *Id.* at 541. (Frankfurter, J., dissenting). *Accord* Hines v. Davidowitz, 312 U.S. 52 (1941) which held: "In general, the states may exercise any power possessed by them prior to the adoption of the Constitution unless the exercise of such power

are insufficient to preempt a state statute. The Montana District Court went on to find no direct conflict between the Montana coal severance tax and the Mineral Lands Leasing Act of 1920.[89] The court disagreed with the producers' and utilities' contention that the levy of severance taxes frustrated federal congressional purposes to maintain control over all the revenues received from federal lands. The court explained that the royalty sharing system created by the Act[90] expressly allows the state a right to tax the output of federally owned lands[91] and quoted from the statute:

> Nothing in this chapter shall be construed or held to affect the rights of the states or other local authority to exercise any rights which they may have, including the right to levy and collect taxes upon improvements, output of mines, or other rights, property or assets of any lessee of the United States.[92]

The Montana District Court also addressed the producers' and utilities' argument that federal energy policies encourage coal production and therefore preempt Montana's coal severance tax. The court noted that the "tax is not an 'obstacle' to federal policy in a constitutional sense merely because it increases the cost or price of a product, the use of which Congress encourages or favors."[93] Thus, the Montana District Court dismissed the claims that the Montana tax was preempted by any federal congressional action.

On appeal, the Montana Supreme Court affirmed the lower court's conclusions on the constitutional issues presented and upheld the

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is expressly or by necessary implication prohibited thereby or interferes with some power delegated to the United States." 312 U.S. at 53 (1941).

89. 30 U.S.C. § 181-209 (1976 & Supp. III 1979).

90. The statutory formula provides for disbursements of 50 percent of the revenues to the state in which the mining occurs; 40 percent to the reclamation fund under the Reclamation Act, 43 U.S.C. §§ 391-401 (1976); and the remaining 10 percent to the U.S. Treasury pursuant to 30 U.S.C. § 191 (1976). *See infra* text at notes 255-261.

91. One of the rallying cries for the lobbyists against western coal severance taxes has been the emphasis on the public ownership of coal reserves. It is important, therefore, to point out that a lease of the mineral rights conveys possession of those minerals to the lessor. The state, by taxing the activities of that lessor, in no way infringes on the presently held ownership rights of the public. *See Federal Preemption of State Energy Policies Hearings, supra* note 6, at 85 (statement of Mont. Att'y Gen. Mike Greely). The Court in Mid-Northern Oil Company v. Montana, 268 U.S. 45 (1925), held that:

> [a]lthough the [Mineral Lands Leasing] Act deals with the letting of public lands and the relations of the government to the lessees thereof, nothing in it shall be so construed as to affect the rights of the states, in respect of such private persons and corporations, to levy and collect taxes as though the government were not concerned.

Id. at 49.

92. 30 U.S.C. § 189 (1976).

93. LAW REPRINTS, *supra* note 26, at 255.

coal severance tax.[94] The state Supreme Court acquiesced in the use of the *Heisler* mechanical test and held that the tax was levied on an activity which preceded interstate commerce, thereby removing it from commerce clause scrutiny. Nevertheless, the court acknowledged the possibility that the correct inquiry was under the *Complete Auto Transit* flexible test and remarked that, even if this test applied, the producers and utilities would not have prevailed.[95] The key question under the *Complete Auto Transit* test was whether the tax was fairly related to the services provided by the state.[96] The state Supreme Court concluded that Montana is completely justified in requiring the coal mining industry to assume its share of the costs incurred by the state and local governments as the direct result of such coal mining.[97] Thus, the Montana Supreme Court found the severance tax valid under a commerce clause challenge.[98]

The state Supreme Court also affirmed the District Court's findings under the supremacy clause challenges. The court first noted that "no national policy can be discerned as a matter of law"[99] and, therefore, there can be no federal preemption of the state's coal severance tax. It next addressed the Mineral Lands Leasing Act of 1920 and agreed that the statute's express allowance of state resource taxation militates against the producers' and utilities' position. The producers and utilities requested that a factual determination be made to determine whether national policy was actually frustrated by the coal severance tax; however, the court stated that the scope and substance of national policy are matters of statutory interpretation which do not require the taking of testimony.[100] As a result of its conclusions, the Montana Supreme Court affirmed the

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94. 615 P.2d 847 (Mont. 1980).

95. *Id.* at 854-55. The Montana Supreme Court emphasized recent U.S. Supreme Court decisions as evidence of the trend to preserve resource production and extraction as fields for state taxation, stating:

> [A] seller State has various means of obtaining legitimate contribution to the cost of its government, without imposing a direct tax on interstate sales. While these permitted taxes may in an ultimate sense come out of interstate commerce, they are not, as would be a tax on gross receipts, a direct imposition on that very freedom of commercial flow which for more than 150 years has been the ward of the Commerce Clause.

615 P.2d at 854-55 (Mont. 1980) (quoting Freeman v. Hewit, 329 U.S. 249, 256 (1946)).

96. For a discussion of the *Complete Auto Transit* test, see *supra* note 68.

97. 615 P.2d 847, 855 (Mont. 1980).

98. *Id.* at 847.

99. *Id.* at 861.

100. *Id.* at 860.

lower court's dismissal based upon the failure of the producers and utilities to state a claim for which relief could be granted.[101]

2. The United States Supreme Court

The Montana coal severance tax was upheld by the state courts; the producers and utilities, therefore, appealed to the United States Supreme Court. The Montana tax was upheld once more.[102] In the Supreme Court's judgment, the validity of the tax turned on the "operating incidence" of the tax – whether the state's power was exercised in proper proportion to the activities of the coal producers.[103] In formulating its opinion, the Court renounced its earlier reasoning based on the *Heisler* trilogy[104] and instead developed the commerce clause analysis enunciated in *Complete Auto Transit, Inc. v. Brady.*[105] Unlike the mechanical *Heisler* test, *Complete Auto Transit* established a four-pronged balancing test which focuses on the practical effect of the challenged tax. In order for a state tax to be valid under the commerce clause, it must meet all four criteria: first, the tax must be applied to an activity with a substantial nexus with the taxing state; second, the tax must be fairly apportioned; third, the tax must not discriminate against interstate commerce; and fourth, the tax must be fairly related to services provided by the state.[106] The Supreme Court concluded that the Montana coal severance tax satisfied all four prongs of the *Complete Auto Transit* test.

The producers and utilities attacked the Montana tax under the third prong of the test by asserting that the tax is, in fact, discriminatory because the tax burden is borne primarily by out-of-state utility consumers.[107] In refuting this claim, the Court noted

101. *Id.* The Montana Supreme Court supported its position by noting that:

> [W]e should be slow to strike down legislation which the state concededly had power to enact, because of its asserted burden on the federal government. For the state is powerless to remove the ill effects of our decision, while the national government, which has the ultimate power, remains free to remove the burden.

615 P.2d at 860 (Mont. 1980) (quoting Pennsylvania Dairies v. Milk Control Comm'n, 318 U.S. 261, 275 (1943)).

102. 453 U.S. 609-11 (1981).

103. *Id.* at 625 (quoting General Motors Corp. v. Washington, 377 U.S. 436, 440-41 (1964)).

104. *Id.* at 617. *See supra* notes 69-70.

105. 453 U.S. 609, 614-16 (1981).

106. *Id.*; Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

107. Appellants' Complaint ¶ 18, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 98. This argument was also advanced by the amici states in *Heisler,* where Pennsylvania shipped 80 percent of its anthracite coal out-of-state and was charged with impermissibly burdening interstate commerce with a severance

that most commerce clause discrimination cases focus on the different tax treatment afforded interstate and intrastate commerce activities. Those cases are premise on the claim that state boundaries should be irrelevant to commercial transactions.[108] The Court noted that the Montana coal severance tax is levied on all coal extracted in the state, regardless of its interstate or intrastate destination, and the Court remarked that for it to "invalidate the Montana tax solely because most of Montana's coal is shipped across the very state borders that ordinarily are to be considered irrelevant would require a significant and, in our view, unwarranted departure from the rationale of our prior discrimination cases."[109] Thus, according to the Court, the tax does not discriminate in a manner prohibited by the commerce clause.

The producers and utilities also challenged the tax under the fourth prong of the *Complete Auto Transit* test which requires that the tax be fairly related to services provided by the state. The producers' and utilities' position assumed that the tax was intended to reimburse the state for the cost of specific services; consequently, the state's power to tax is limited by the value of those services actually provided. The Court's perception of the issue was very different.[110] The Court reasoned that because the tax is measured as a percentage of the value of the coal taken from Montana, the tax is in proper proportion to the taxed activity in the state.[111] The Montana

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tax. The Court then, as now, was reluctant to judge the validity of a state tax by assessing the exportation of the tax burden. 453 U.S. 609, 618 (1981). *See* Brief for the United States as Amicus Curiae at 24, Commonwealth v. Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 736.

108. 453 U.S. 609, 618-19 (1981). The Court stated "in matters of foreign and interstate commerce there are no state lines." *Id.* (quoting West v. Kansas Natural Gas Co., 221 U.S. 229, 255 (1911)).

109. 453 U.S. 609, 619 (1981). In addition, the Court rejected the use of the commerce clause as a "sword" to grant residents of one state a right of access at "reasonable" prices to resources located in another state irrespective of whether or on what terms the residents of the resource-rich states have access to those resources. *See* Brief for the United States as Amicus Curiae at 25 n.16; Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 737. The Court stated "[w]e are not convinced that the Commerce Clause, of its own force, gives the residents of one State the right to control in this fashion the terms of resource development and depletion in a sister State." 453 U.S. 609, 619 (1981). *Cf.* Philadelphia v. New Jersey, 437 U.S. 617, 626 (1978).

110. 453 U.S. 609, 620-21 (1981).

111. *Id.* at 626. The Court stated "[w]hen a tax is assessed in proportion to a taxpayer's activities or presence in a state, the taxpayer is shouldering its fair share of supporting the State's provision of 'police and fire protection, the benefit of a trained work force, and the advantages of a civilized society.' " *Id.* at 627. *See* Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 228 (1980) (quoting Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 445 (1979)).

tax was found to be fairly related to state-provided services solely because it is based on the quantity and quality of the coal extracted. The Court engaged in no factual inquiry into the fairness of the relationship between revenues generated and costs incurred.

Concluding that the Montana tax satisfied the *Complete Auto Transit* test, the Supreme Court went on to discuss the practical effect of the tax. It stated unequivocally that "[t]here can be no question that Montana may constitutionally raise general revenue by imposing a severance tax on coal mined in the state."[112] The Court explained that the individual consumers in another state may legitimately be required to pay the tax even though they derive no direct gain from the tax revenues and they are not directly responsible for the costs incurred by coal development.[113] The Court framed the controlling question to be whether the state has given anything for which it can ask recompense in return,[114] and concluded that:

> [w]hen, as here, a general revenue tax does not discriminate against interstate commerce and is apportioned to activities occurring within the State, the State 'is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the State has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society.'[115]

Because the Montana coal severance tax compensates the state for the depletion of its natural resource base as well as the provision of necessary public services it is a legitimate exercise of state power according to the Court's opinion, regardless of who actually pays the tax.

Addressing the supremacy clause issue, the Supreme Court dismissed the contention that the Montana tax was preempted by federal legislation and policy. The producers and utilities asserted that the state severance tax conflicts with the system of sharing federal receipts from mineral leases on public lands which was established by the Mineral Lands Leasing Act of 1920.[116] The Court rejected that argument by noting Congress intended through the Act to provide a fair return to the public and not to retain all the

112. 453 U.S. 609, 624 (1981).

113. *Id.* at 622-23 (quoting Carmichael v. Southern Coal and Coke Co., 301 U.S. 495, 521-22 (1937)).

114. *Id.* at 625. *See* General Motors Corp. v. Washington, 377 U.S. 436, 440-41 (1964); Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940).

115. *Id.* at 624-25 (quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940)).

116. 30 U.S.C. §§ 181-209 (1976 & Supp. III 1979).

revenues from the mineral leasing of federal lands.[117] The Supreme Court then turned to the numerous federal statutes cited by the producers and utilities to support their position that the Montana tax substantially frustrates national energy policy and, therefore, is preempted.[118] The Court found only one statute, the Powerplant and Industrial Fuel Use Act of 1978,[119] to contain "specific statutory provisions favoring the use of coal."[120] The Court further noted, however, that even this statute clearly contemplates the continued existence of state coal severance taxes.[121] As a result, the Court found no direct conflict between the Montana tax and any federal statute and upheld the tax against the supremacy clause challenges.

Although the Montana coal severance tax was upheld by a majority of the Supreme Court, four justices were troubled by the outcome of the *Commonwealth Edison* case. Three justices dissented[122] on the ground that a trial on the facts was necessary to determine adequately the practical consequences of the tax — in particular, a judicial factfinding would show the extent to which interstate commerce may be unduly burdened.[123] Justice White, concurring in the majority's decision, nevertheless expressed considerable doubt about the case's result and concluded that "the better part of both wisdom and valor is to respect the judgment of the other branches of the government," and wait for Congress to act.[124] This combination of opinions indicates that the decision in *Commonwealth Edison* does not represent overwhelming judicial approval of current state taxation of energy resources.

The majority of the Court itself questioned the judiciary's ability to resolve successfully the immense and intricate problems of state taxation and national economic and energy policies. Justice Marshall in the majority opinion expressed the reservation that "it is doubtful whether any legal test could adequately reflect the numerous and competing economic, geographic, demographic, social, and political

117. *Id.* at 632. The House Report on the 1975 Amendments speaks only in terms of a congressional intent to secure a "fair return to the public." H. REP. NO. 681, 94th Cong. 2d Sess., 17-18, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 1943, 1953.

118. *See infra* text and notes at notes 230-238.

119. 42 U.S.C. §§ 8301-8483 (Supp. III 1979).

120. 453 U.S. 609, 634 (1981).

121. *Id.* at 636.

122. Justices Blackmun, Powell, and Stevens dissented. *Id.* at 638-53.

123. *Id.* at 651-53.

124. *Id.* at 637, 638 (White, J., concurring). Justice White's concurring opinion was made "with the realization that Montana's levy on consumers in other States may in the long run prove to be an intolerable and unacceptable burden on commerce." *Id.*

considerations that must inform a decision about an acceptable rate or level of state taxation."[125] The Court resolved the problem in an inconclusory manner by leaving the decision with the state legislatures except where particular state taxes are thought to be contrary to federal interests. In such cases, Congress should determine the appropriate tax rate.[126] Obviously, the Court's opinion leaves some fundamental questions unanswered. Who decides when the level of a state's tax becomes unacceptable? When do the federal interests in a national energy policy outweigh the state's prerogative to tax activity within its borders? The next section will address these questions by focusing on the proper legislative forum in which to fashion an equitable tax on coal development.

III. The Proper Legislative Forum

Federal-state tensions are inherent in our constitutional federalism; each state's political autonomy is subject to the national good.[127] The economic interdependency of every state heightens the tension. The taxation of energy resources illustrates well the difficulty of accommodating the states' needs and wants with the nation's economic stability. While the federal government seeks to develop abundant, low-cost energy supplies,[128] the energy-producing states demand reimbursement for production costs[129] and the energy-importing states balk at paying those costs.[130] Any state legislative forum must consider and meet the needs of its constituency. The federal legislative forum must develop and implement a coherent national policy to manage energy resource production. Both federal and state legislative bodies must balance their competing interests to develop equitable responses attuned to the marketplace where the economic consequences of such decisionmaking are evidenced. The federal legislative forum has had difficulty implementing a cohesive energy policy, while the state legislative bodies, fully cognizant of the costs of energy production and consumption, have acted on their own. While the taxation of energy production is properly within the purview of state legislatures, it remains to be seen what concerns and constraints must be taken into account in order to fashion an equitable resource tax system.

125. *Id.* at 628.
126. *Id.*
127. *See supra* notes 17-18.
128. *See infra* text at notes 232-35.
129. *See supra* text at notes 6-9; *infra* text at notes 148-84.
130. *See supra* text at notes 15, 53-65.

A. The State Forum

The state legislature's power to tax is a necessary corollary to its ability to make laws; that power to tax is indispensable to the state's continued existence.[131] The state's sovereign power to tax, however, is necessarily limited within the confines of the United States Constitution.[132] Constitutional challenges of state taxing power are most frequently based on the commerce clause or the due process clause of the Fourteenth Amendment.[133] Commerce clause constraints on state taxation exist only when state taxing schemes substantially burden interstate commerce.[134] Due process limitations may be imposed if the statute favors intrastate business over interstate business.[135] Even if a state tax is within these constitutional parameters, it may still be restricted by specific congressional action taken pursuant to its plenary commerce clause powers.

In the case of Montana, the state legislature responded to the coal boom of the early 1970's by enacting a tax mechanism designed to pay the costs of administering mining and reclamation laws while providing revenues to mitigate the social and environmental impacts of massive coal production.[136] Montana in particular is cognizant of the "rip, profit, and run" practices of some natural resource developers.[137] In the early 1900's, Montana saw 46 million tons of copper severed from its land by a large out-of-state corporation, Anaconda Copper;[138] it saw the city of Butte boom to a pre-World

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131. Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 10 (1824). Alexander Hamilton developed this position in the Federalist Papers by stating:

> [T]he individual states should possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants. And making this concession, I affirm that . . . they would, under the plan of the convention, retain that authority in the most absolute and unqualified sense; and that an attempt on the part of the national government to abridge them in exercise of it, would be a violent assumption of power, unwarranted by any article or clause of its constitution.

THE FEDERALIST No. 32, at 61 (A. Hamilton) (A. Hacker, ed., 1964).

132. The Supreme Court found that the power to tax is the power to destroy. M'Culloch v. Maryland, 17 U.S. (4 Wheat.) 415, 433 (1819). As a result, the state's power to tax must be exercised within the constitutional limits which allow that power.

133. *See* Parnell, *supra* note 30.

134. *See infra* text at notes 210-22.

135. The due process clause of the fourteenth amendment, U.S. CONST. amend. XIV.

136. *See infra* text at notes 148-84. *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 76 (statement of Mont. Att'y Gen. Mike Greely).

137. *See Federal Preemption of State Energy Policies Hearings, supra* note 6, at 97 (statement of Marjorie Harper, President, Clark Fork Basin Protective Ass'n).

138. Nat'l Tax Ass'n — Tax Inst. of America, Proceedings of the 72nd Annual Conference, *Louisiana's First Use Tax* (presentation of Rep. Billy Tauzin, Chairman, Louisiana House Natural Resources Committee) 194, 197 (1979); *Coal Severance Tax Hearing, supra* note 1, at 100 (citing National Journal, Mar. 22, 1980).

War I population of over 100,000 and bust to a dwindling population of less than 25,000;[139] it saw the open-pit mines grow, encircle the city, and scar the terrain;[140] and perhaps worst of all, it saw the out-of-state lobbying interests control its legislative process.[141] The developers were the largest employers in the state and they owned every sizable daily newspaper.[142] Left with an environmental and social disaster from that copper development, Montana is acutely aware of the potential costs of coal development.

The western states' Northern Great Plains environment is comprised of a composite of social, cultural, and physical factors. The current national demand for coal necessitates a transformation of that environment, subsuming it into energy and economic concerns. The resulting sensation of being a colony subject to manipulation by outside forces is prevalent in the region;[143] perhaps this attitude is due in part to the realization that sparse populations[144] may provide less opposition to the sacrifice of their land.[145] The transiency of the

139. *Coal Severance Tax Hearing, supra* note 1, at 340 (statement of Mont. State Sen. Thomas E. Towe); *Commerce Clause Hearings, supra* note 9, at 151.

140. *Coal Severance Tax Hearing, supra* note 1, at 592 (statement of David Alberswerth, Western Organization of Resource Councils).

141. One Montana state official stated, "You could see the Anaconda lobbyists in the Legislature and, honest to God, when votes were taken, they would nod for a yes vote and shake their heads for a no vote." *Coal Severance Tax Hearing, supra* note 1, at 109 (citing Minneapolis Star, June 10, 1980).

142. *Id.* In addition, the wealthy copper kings did not bestow their largesse on Montana institutions, but rather preferred to benefit corporate headquarters and bankers in New York City, the Corcoran Art Gallery in Washington, D.C., the University of Virginia, and Stanford University. *Coal Severance Tax Hearing, supra* note 1, at 340 (statement of Mont. State Sen. Thomas E. Towe); *Commerce Clause Hearings, supra* note 9, at 151 (statement of Mont. State Sen. Thomas E. Towe).

143. *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 58 (statement of N.D. Att'y Gen. Allen I. Olson); *Commerce Clause Hearings, supra* note 9, at 98 (statement of N.D. U.S. Rep. Byron L. Dorgan). The western coal-producing states "have shown that they are willing to allow strip-mining to help supply energy to the rest of America. But, we are determined that we will not be made a national sacrifice area in order to heat Minneapolis and air condition Detroit. We are determined that we will not allow the development of this energy without requiring this development to pay its own way. We do not have large industrial tax bases to pick up any slack, and we simply are not going to allow the costs to fall on our farmers, workers, small business people, or on future generations." *Id.*

144. *See* BUREAU OF THE CENSUS, UNITED STATES DEP'T OF COMMERCE, STATISTICAL ABSTRACTS OF THE UNITED STATES (100th ed. 1979) (stating that Montana has a population of 785,000 and 147,138 square miles, Wyoming contains a population of 424,000 and 97,914 square miles, and North Dakota has a population of 652,000 and 70,048 square miles), *cited in Federal Preemption of State Energy Policies Hearings, supra* note 6, at 129 (App., paper of Prof. Daniel H. Henning).

145. Marjorie Harper, President of the Clark Fork Basin Protective Association expressed her fears that "[w]ith a government that functions on the principle of the greatest good for the many, a sparsely populated area like Montana can easily become a sacrifice area." *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 97.

"boom" cycle also points to the exploitative nature of the development of coal which, if not carefully controlled, will leave behind a lunar landscape and local government debts reaching far into the future.[146] Therefore, the decision by western coal-producing states to impose coal severance taxes is based on the equitable notion that those who benefit from power generated by the combustion of western coal reserves must assume a small portion of the cost of providing those fuel reserves.[147]

1. Examining the Costs of Coal Development

Increased resource extraction results in three types of costs to state government:[148] the ordinary costs of providing public services; the extraordinary costs of enduring environmental injury; and the future costs of losing non-renewable resources. The costs associated with coal development are considered particularly onerous due to the massive disruption of the terrain caused by strip-mining and the expensive transportation problems of moving coal.[149] The western state legislatures, confronted with these costs at every session, must decide how best to meet the needs presented to them. The following sections will outline the costs which must be met by either state or local government treasuries.

a. Ordinary Costs

Ordinary costs associated with coal production include community impact problems and services required due to industrial development, environmental monitoring, and highway construction. Rapid population increases occasioned by industrial manpower needs create huge increases in the demand for public services, requiring significant[150] and immediate[151] capital expenditures by local government. In an attempt to estimate the likely impact costs to the

146. *Coal Severance Tax Hearing, supra* note 1, at 341 (statement of Mont. State Sen. Thomas E. Towe).

147. *Coal Severance Tax Hearing, supra* note 1, at 17 (statement of Wyo. U.S. Sen. Alan K. Simpson).

148. Peters, *An Outline for Development of Cost-Based State Severance Taxes,* 20 NAT. RESOURCES J. 913, 922-926 (1980); Link, *Political Constraint and North Dakota's Coal Severance Tax,* 31 NAT'L TAX J. 263, 265 (1978).

149. *See infra* note 155.

150. Local costs are significant not only in terms of services and facilities required but in terms of the premium paid for the money to provide those services and facilities as well. In rapidly growing communities whose fortunes are uncertain, the usual 20-year amortization period is reduced to 3 to 5 year repayment periods. *Commerce Clause Hearings, supra* note 9, at 152 (statement of Mont. State Sen. Thomas E. Towe); *Coal Severance Tax Hearings, supra* note 1, at 148 (statement of Wyo. U.S. Rep. Dick Cheney).

151. Most major coal deposits lie in areas where local government has little or no excess

western coal producing states, the Congressional Budget Office concluded that local governments could reasonably anticipate spending $7,122 for capital investments and an additional $1,714 in operating costs for each new person entering a coal development area.[152] Assuming conservative population increases, the resulting fiscal outlays required of affected local governments are enormous — $85 million in capital investments and $20 million in operating costs.[153]

To a rural community, a population increase of only 1,000 people has a significant effect. To accommodate those 1,000 additional residents, the local government must provide 100,000 more gallons of water per day and a place to store it; an additional 2 miles of sewer lines; $175,000 worth of sewer treatment facilities; 6 miles of streets; $100,000 worth of signs; 102 street lights; 4.8 acres of parks; one-third of a garbage truck; one-sixth of a fire truck; 1.8 policemen; 1.5 firemen; 6.5 miscellaneous employees; 4.8 elementary classrooms; and 3.6 high school classrooms.[154] Funding must also be provided to maintain everything in operating order. The strains caused by the dramatic population increases in rural coal-producing areas are apparent.

A second ordinary cost borne by those states faced with potentially massive coal development is that of environmental protection. En-

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capacity to deliver increased services. It takes up to 3 years to ready a coal mine for operation and in the meantime local residents face the prospect of either watching the quality of their existing services decline or seeing the burden of local taxes rise. *See Coal Severance Tax Hearing, supra* note 1, at 341 (statement of Mont. State Sen. Thomas E. Towe); STATE TAXATION OF MINERAL DEPOSITS AND PRODUCTION, U.S. DEP'T OF AGRICULTURE, ECONOMIC DEVELOPMENT DIVISION 2, 14-15 (1978) [hereinafter cited as STATE TAXATION].

This so-called "front-end financing problem" has been innovatively addressed by the state legislatures of Montana, Wyoming, and Utah. With the creation of a Coal Board to administer impact assistance, Montana provides direct local aid by requiring new developments with a major impact on existing public services to prepay, on request, an amount up to three times the estimated property tax due on the completed facility. *See* MONT. CODE ANN. § 15-16-201 (1981)). Wyoming authorized the issuance of revenue bonds to finance a state Community Development Authority which can loan funds to both private and public sector institutions. WYO. STAT. § 9-18-101-123 (1977 & Supp. 1981). Utah enacted a program centered on the prepayment of sales and use taxes on the equipment and machinery used in the development and production of resources. However, because the legislature must approve the projects to receive funding, the efficient and timely distribution of monies is uncertain. UTAH CODE ANN. §§ 63-51-5-71 (1981). *See* STATE TAXATION, *supra* note 151, at 14-19.

152. *See Coal Severance Tax Hearing, supra* note 1, at 342 (statement of Mont. State Sen. Thomas E. Towe) (citing CONGRESSIONAL BUDGET OFFICE REPORT: ENERGY DEVELOPMENT, LOCAL GROWTH AND THE FEDERAL ROLE).

153. *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 46 (statement of Mont. State Sen. Thomas E. Towe). These figures assume coal industry employment needs will increase each impacted community's population from 4,000 to 12,000 people. *See id.*

154. *Coal Severance Tax Hearing, supra* note 1, at 141 (statement of Wyo. U.S. Sen. Malcolm Wallop).

vironmental monitoring is essential to any industrial development, but none more so than strip-mining activities.[155] The administrative burden on the state in reviewing and granting mining permits, reviewing mining plans, reviewing and approving reclamation plans, inspecting the mines, and generally monitoring conformance with the state environmental protection laws is considerable.[156] Since most of the coal reserves in the western states are surface mined, the states face unavoidable costs to ensure adequate environmental safeguards.

The third ordinary cost resulting from increased coal production is highway construction, perhaps the largest single investment required of the state government's treasury.[157] In Montana, over 300 miles of identified roads[158] comprising eleven routes service existing coal mines and the towns which house their workers. These roads are dirt, gravel, or lightly paved.[159] Enormous capital outlays are needed to upgrade or reconstruct the present system to meet the heavier standards required to transport coal. The deterioration of existing highway systems and the demand for new construction are caused by current and anticipated increases in western coal traffic — the 97 million tons per year transported in 1975 is expected to swell to 307 million tons in 1985 and to reach 625 million tons per year by 1990.[160] Montana estimates it will need $64 million to provide adequate roads to accommodate this increased coal production.[161]

b. Extraordinary Costs

Extraordinary costs associated with the development of coal in the western states include risks to the unique western environment and alteration of a special social fabric. The phrase "the West" evokes a vision of frontier expanses and pioneering peoples, evidencing a

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155. *Commerce Clause Hearings, supra* note 9, at 103 (statement of N.D. U.S. Rep. Byron L. Dorgan); *id.* at 159 (statement of James C. Rosapepe, Multistate Tax Comm'n).

156. *Coal Severance Tax Hearing, supra* note 1, at 340 (statement of Mont. State Sen. Thomas E. Towe).

157. *Id.* at 329 (statement of Mont. State Sen. Thomas E. Towe).

158. *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 93 (statement of Roger Tippy, Mont. Att'y).

159. *Id.*

160. Coal: Transportation Hangups Cause Headaches as Industry Tries to Increase Exports [1980] ENERGY USERS REP. (BNA) 376:21.

161. *Commerce Clause Hearings, supra* note 9, at 152 (statement of Mont. State Sen. Thomas E. Towe). Most studies, including those of the Congressional Budget Office and National Economic Research Associates (hired by the utilities to support their position to limit state tax rates), fail to account for road costs. While Montana has identified $64 million in road work required by impacted areas, it has allocated only $15 million for this purpose to date. *Id.*

special American heritage. The West is an undeveloped and sparsely populated land. Among its physical assets are clear skies, untrammeled terrain, and few people. The hope of retaining that western heritage is dimmed by the fact that the region holds one of the world's largest and richest coal deposits, containing an estimated 75 billion tons of relatively clean, easily-mined coal.[162]

The western states are surrendering their huge coal seams, 100 feet thick and lying under only 25 to 50 feet of earth. With shovels able to remove 100 tons of earth in a single scoop,[163] western lands are being irreversibly altered.[164] In an effort to address these problems reclamation of all strip-mined land is required by both federal and state statutes.[165] The topsoil is preserved during the mining activities and later the land is regraded and planted.[166] Nevertheless, even with considerable sums of money expended to reclaim the land,[167] the terrain is changed, the plantlife is altered, the native wildlife is displaced and may not return, and the ground water may be degraded.[168] The soil and the plant and animal communities de-

162. *Coal Severance Tax Hearing, supra* note 1, at 108 (citing Minneapolis Star, June 10, 1980).

163. *Id.*

164. In Colstrip, Montana, the strip mining of 78.8 million tons of coal has "disturbed" over 3,200 acres of land — 5 square miles — half of which has begun to be reclaimed. WESTERN ENERGY COMPANY, COLSTRIP FACT SHEET 3 (1981). If the synfuels industry develops to levels of production of 15 million barrels of oil a day as projected by C.C. Garvin, Jr., Chairman of Exxon, Corp., 15 strip mines would be required — each 3 miles long and 1 1/2 miles wide. Water would be required as well — 30 to 45 million barrels per day. *Coal Severance Tax Hearing, supra* note 1, at 102 (citing National Journal, March 22, 1980).

165. The Montana Strip and Underground Reclamation Act, MONT. CODE ANN., §§ 82-4-201-254 (1981), and the Federal Surface Mining Control and Reclamation Act of 1977, 30 U.S.C. §§ 1201-1309 (1976 & Supp. III 1979).

166. THE WESTERN ENERGY COMPANY, COLSTRIP FACT SHEET 3 (1981) describes the reclamation process as follows:

> Following mining, reclamation begins with regrading disturbed land to its approximate original contour. Drainages are reconstructed and the surface recontoured to minimize erosion and maximize benefits from precipitation. The main objective of the reclamation program is to restore disturbed lands to a permanent, diverse vegetative cover of predominantly native plant species suitable for livestock grazing and wildlife habitat. . . . The present revegetation strategy involves a two-phase seeding sequence. In the first phase, selected forbs, shrubs and warm season grasses are broadcast seeded and allowed to develop for at least one growing season. The second phase consists of drill seeding a permanent cool season perennial grass mixture. The use of two-phased seeding avoids the deleterious competition between different plant life forms and promotes plant community diversity.

Id.

167. The reclamation bonds required of coal producers cost between $4,000 to $6,000 per acre. Conversation with Bill Schwarzkoph, Reclamation Supervisor, Western Energy Company, Jan. 8, 1982. The cost of reclamation, primarily for regrading, ranges from $16,000 to $23,000 per acre. WESTERN ENERGY COMPANY, COLSTRIP FACT SHEET 4 (1981).

168. *Coal Severance Tax Hearing, supra* note 1, at 425-26 (statement of Sally Hunt

pendent on it took centuries to develop; the renewal of balanced communities necessary for total reclamation will take hundreds of years in the arid West.[169] In addition, coal serves as a water-course[170] and the mining of coal disturbs existing aquifers vital to any agricultural use of western lands.[171] These extraordinary environmental costs occasioned by the mining of coal are certainly not minimal to the coal-producing state.

The changes worked into the social fiber of the western rural communities are equally permanent.[172] Small close-knit towns must expand to house, feed, entertain, and support thousands of transient residents. Facilities necessary to accommodate the needs of a young work force, such as recreational centers and day care services, are usually nonexistent.[173] Increased crime, greater familial problems, and alcoholism are not uncommon in these impact areas.[174] Called upon to meet the demands of an ever-increasing population after years of static or declining numbers, the local governments in these coal-rich areas are straining every facility and every public service.[175] The social and cultural changes occasioned by increased coal development is an extraordinary cost which, although difficult to quantify, is no less significant.

c. Future Costs

The future costs associated with the development of coal include reclamation of the mined areas and preservation of the economic

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Streiter, Nat'l Economic Research Associates, Inc.).

169. *Coal Severance Tax Hearing, supra* note 1, at 341 (statement of Mont. State Sen. Thomas E. Towe).

170. A water-course is a bed or channel for water. *See Coal Severance Tax Hearing, supra* note 1, at 424 (statement of Sally Hunt Streiter, Nat'l Economic Research Associates, Inc.).

171. *Id.*

172. Helen Waller, Chairwoman of the Northern Great Plains Resource Council, noted the intra-community disagreement over resource development in rural western towns, and remarked "even though there has been no coal extracted, we have already been impacted and no money is going to ever, you know, quite bring our community back to what it was. . . ." *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 41.

173. Dr. J. Uhlman of the Denver Research Institute, and former Director of the Wyoming Human Service Project, surveyed 40 separate energy communities and found, in pertinent part:

> 70% had no mental health facilities;
> 52% had no alcoholism counseling;
> 47% had no movie theatre; and
> most had no family planning services.

Coal Severance Tax Hearing, supra note 1, at 341 (statement of Mont. State Sen. Thomas E. Towe).

174. *Id.* at 332.

175. Helen Waller, Chairwoman of the Northern Great Plains Resource Council, discussed the effects of development on local schools:

base of the state. Strip-mined land requires long-term reclamation and maintenance efforts to erase the damage done by development.[176] Although bonds required by the Surface Mining Control and Reclamation Act of 1977[177] have been posted, fears exist of unforeseen and undetected problems which may not be adequately corrected through reclamation funds alone. The western coal-producing states point to the unaddressed issues of mining-related health problems and land surface subsidence which currently exist in Appalachian coal areas.[178] Convinced that there will be major future costs as yet unknown, the western states are placing a portion of coal severance tax revenues into inviolate trusts designed to meet those contingencies.[179]

In addition, the extraction of nonrenewable resources represents a depletion of the state's economic base.[180] It is a one-time harvest.[181] The mining of coal will continue only as long as it is profitable to do so. Once western coal's marketability declines, the coal producers will disappear and the "boom" will quickly become "bust." The future costs of decay in abandoned urban areas and of local government debt are uncertain and troubling.

State and local governments must pay for the staggering costs associated with coal development. These costs are not adequately met through traditional state revenue sources, even when combined with federal impact aid. No property tax revenues are received from the large areas of federal lands.[182] In addition, Congress' spending habits do not provide a reliable source of assistance to the states.

> Now I realize that the impact money helps to pay for the construction of a building, although the local people still pick up part of the tab, but even so, the physical building is a small part of the kids' education. One for-instance that I know of, and I'm sure you've heard this one before, is the fact in Colstrip, in one year, one particular child I know had eight teachers. Now that's a cost that that child is paying that no amount of dollars will ever make up for.

Federal Preemption of State Energy Policies Hearings, *supra* note 6, at 41.

176. *See supra* note 166.

177. 30 U.S.C. § 1259 (Supp. III 1979). *See Coal Severance Tax Hearing*, *supra* note 1, at 670.

178. *Coal Severance Tax Hearing*, *supra* note 1, at 341 (statement of Mont. State Sen. Thomas E. Towe).

179. Under the terms of a 1976 amendment to the Montana Constitution, after December 31, 1979, at least 50 percent of the revenues generated by the coal severance tax must be paid into a permanent trust fund, the principal of which may be appropriated only by a vote of three-fourths of the members of each house of the state legislature. MONT. CONST. art. IX, § 5 (1981). The legislature may allocate the interest from the trust fund as it sees fit. *Id.*

180. Commonwealth Edison Company v. Montana, 453 U.S. 609, 624 (1981).

181. Peters, *supra* note 148, at 925; Link, *supra* note 148, at 264-65.

182. It has been a long-established principle of constitutional federalism that states may not tax the federal government. M'Culloch v. Maryland, 17 U.S. (4 Wheat.) 415 (1819).

Congress recently enacted three impact aid bills intended to mitigate local costs — the legislation was never funded.[183] The western states are forced to pay most of the increased costs of coal development by themselves and, even with large tax receipts, some states are expecting revenue shortfalls.[184]

2. Choosing a Severance Tax

Thirty-three states[185] have thus far concluded that the costs associated with natural resource development cannot be handled by conventional taxes alone.[186] Instead, an industry-specific tax — a severance tax — is required to meet those costs. A severance tax is a payment for the privilege of severing natural resources from the soil or water.[187] It is measured by the market value or quantity of the resource removed or sold[188] and is usually imposed on energy-related products.[189]

Severance taxes on energy resources have come under national scrutiny due to the sharp increase in state revenues generated by

183. *Coal Severance Tax Hearing, supra* note 1, at 30 (statement of Wyo. U.S. Sen. Alan K. Simpson).

184. Although the receipts from energy resource production taxes are considerable, the costs which attend development are also significant. North Dakota is projecting a shortfall of $10 million based on a North Dakota Regional Environmental Assessment Program Study, and Wyoming has identified a $27 million shortfall based on an Old West Regional Commission Report. *Coal Severance Tax Hearing, supra* note 1, at 341 (statement of Mont. State Sen. Thomas E. Towe).

185. These states are: Alabama, Alaska, Arkansas, California, Colorado, Florida, Idaho, Indiana, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, North Dakota, Ohio, Oklahama, Oregon, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, and Wyoming. *See Commerce Clause Hearings, supra* note 9, at 114 (statement of Shirley Kallek, Bureau of the Census); [1981] 2 STATE TAX GUIDE (CCH) ¶¶ 45-200 to 45-955.

186. Mineral property was first taxed by an ad valorem property tax which is based on a mine's assessed value and the local millage rate. This tax is levied whether the mineral deposit is being worked or not, and is found in use in Pennsylvania and Illinois. STATE TAXATION, *supra* note 151, at 3.

187. A privilege tax is an excise tax, and as such is not subject to constitutional restrictions applicable to property taxes such as millage limits and uniformity provisions. An excise tax and a property tax can be imposed concurrently and are not considered to be an unacceptable double tax. STATE TAXATION, *supra* note 151, at 6.

188. [1980] STATE TAX GUIDE (CCH) ¶ 45-000; *Commerce Clause Hearings, supra* note 9, at 110 (statement of Shirley Kallek, Bureau of the Census).

189. Approximately 90 percent of all severance taxes is derived from energy-related products; the remaining 10 percent is generated by taxes on timber and such minerals as copper, potash, sand and gravel. *Commerce Clause Hearings, supra* note 9, at 110 (statement of Shirley Kallek, Bureau of the Census). Nevertheless, the non-energy resource tax revenues are significant. In 1979, Minnesota, which filed an amici brief in the *Commonwealth Edison* case against Montana's coal severance tax, received more money from its 15 percent severance tax on iron ores than Montana did from its coal severance tax. *Coal Severance Tax*

these taxes — a 44 percent increase between fiscal years 1979 and 1980 alone, with receipts growing from $2.9 billion to $4.2 billion in that year alone.[190] Of the thirty-three states with severance taxes, eight states accounted for 86.6 percent of the national total of $4.2 billion received in 1980.[191] These states are Texas, Alaska, Louisiana, Oklahoma, New Mexico, Kentucky, Florida, and Wyoming.[192] The fourteen states which impose a coal severance tax[193] play a relatively modest role in the nation's energy market when compared to state revenues from oil and gas severance taxes.[194]

Each state has developed its own unique system of taxation, with interactions between types of taxes so complex that any generalized statements about energy resource taxes are not helpful.[195] Texas' oil

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Hearing, supra note 1, at 88 (citing Energy: Limiting State Coal Severance Taxes Report by the Congressional Research Service (1980)).

190. *Commerce Clause Hearings, supra* note 9, at 109 (statement of Shirley Kallek, Bureau of the Census).

191. *Id.*

192. *Id.* Montana, with a 30% coal severance tax, is not included among the top moneymakers. It is interesting to note that Texas, which filed an amici brief in the *Commonwealth Edison* case against Montana's coal severance tax, took in considerably more in severance tax revenues than any other state. In 1980, Texas received $1.525 billion while the second-ranked severance tax state, Louisiana, took in "only" $525 million. *Id.*

193. These states are:

State	*Statute* §§	*Rate*
1) Alabama	40-13-2	13.5¢/ton
	40-13-31	20¢/ton
2) Arkansas	84-2102(b)	2¢/ton
3) Colorado	39-29-106	60¢/ton indexed
4) Florida	211.-3	5% of value
5) Idaho	47-1201	2% of net value
6) Kentucky	143.-020	4 1/2% of gross value
7) Louisiana	47.633(12)	10¢/ton
8) Montana	15-35-103	up to 30% of value
9) New Mexico	7-26-6	82.6¢/ton
10) North Dakota	57-61-01 (1981)	85¢/ton plus 1¢/ton for every 4-pt increase in wholesale price index
11) Ohio	5749.02	4¢/ton
12) Oklahoma	931	5¢/ton
13) South Dakota	10-39A-1	4 1/2% of value
14) Tennessee	67-5902	20¢/ton
15) Wyoming	39-6-302	3%
	39-6-303	2%

Table information compiled by author.

194. *Commerce Clause Hearings, supra* note 9, at 159 (statement of James Rosapepe, Rep., Multistate Tax Comm'n).

195. There are states which levy a tax on coal production which is not denominated a

and gas resources generate incredible revenues — enough for its legislature to consider eliminating all property taxes to complete the state's position of no income or sales taxes.[196] Louisiana currently uses its oil and gas revenues to offset property taxes.[197] Other states, such as Montana, have chosen to place a portion of their severance tax revenues into trust funds in order to reduce the inevitable loss of economic advantage once the nonrenewable resource base is depleted.[198] Moreover, some states raise revenues from mining activities but do not classify the levy as a severance tax per se. This occurs when the taxes take the form of a general sales tax covering items in addition to mined resources. West Virginia, as an example, levies an occupational gross income tax on the proceeds from the sale

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severance tax. *See Commerce Clause Hearings, supra* note 9, at 108 (statement of Shirley Kallek, Bureau of the Census). In addition, the severance tax is just one part of an overall tax burden. In North Dakota, for example, a deduction for federal income taxes is provided from the state corporate income tax. Each state has its own unique system. *Commerce Clause Hearings, supra* note 9, at 102 (statement of N.D. U.S. Rep. Byron L. Dorgan).

A comparison of Montana and Wyoming coal severance taxes illustrates well the individualized nature of each state's tax system.

	Montana	Wyoming
a) F.O.B. Mine Price	5.00	5.00
b) Less Processing Costs	—	4.25
c) Assessed Value	5.00	5.10
d) Severance (excise) taxes	1.50	.535
e) Gross proceeds (ad valorem) taxes	.225	.316
f) Indemnity Trust Fund	.025	—
Total Taxes	1.75	.85
g) Gross Price F.O.B. Mine	6.75	5.85
Total Taxes as % F.O.B. Mine Price	35%	17%

a) F.O.B. Mine Price = the assumed price of the coal prior to taxes or deductions.
b) Processing Costs = Wyoming deducts all crushing, screening, loading, etc. Estimated average deduction is .75 per ton (W.S. 39-2-202).
c) Assessed Value = Wyoming uses a pyramid tax (tax on tax) (W.S. 39-2-202).
d) Severance Taxes = Montana at 30% (Mont. Code Ann. 15-35-101)
Wyoming at 10.5% (W.S. 39-6-202 and 39-6-303).
e) Gross Proceeds Taxes = Montana at mill levy × 45% value
Wyoming at mill levy × assessed value.
f) Indemnity Trust Fund = Montana at .5%
g) Gross Price F.O.B. Mine = the price including taxes — what the customer pays.

MONTANA COAL COUNCIL REPORT, *supra* note 43, at Exhibit G.

196. *Coal Severance Tax Hearing, supra* note 1, at 107 (citing Minneapolis Star, May 12, 1980).

197. In addition, Louisiana's Gov. Treen proposed to reduce income taxes by 36% and pay cash instead of borrowing for capital construction. *Coal Severance Tax Hearing, supra* note 1, at 106 (citing Wall Street Journal, June 16, 1980).

198. *See supra* note 179. Alaska's Permanent Fund is the most sensational. (ALASKA CONST. art. IX, § 15). Using interest monies from the Fund, a recently enacted program distributes an

of coal; yet, the tax is not classified as a coal severance tax.[199] These states have all chosen different means to generate revenues necessary to pay the costs of resource development.

The most common resource tax measures include a true severance tax, a gross production severance tax, and a net production severance tax.[200] A "true" severance tax is not tied to the value of the resource mined, but rather is measured according to a rate schedule based on the mine's production.[201] Some state legislatures have linked the rate schedule to a price index, automatically adjusting the tax for the effects of inflation.[202] The gross production severance tax is levied on a measure of the dollar value of the resource extracted.[203] This tax is designed to compensate for rapid price changes and to account for production of different quality minerals. The disadvantages of this type of severance tax include financial problems resulting from possible periods of depressed prices and administrative difficulties in determining value for those mines where the output is not sold on the market, but is burned at the mouth of the mine.[204] The net production severance tax allows producers to deduct particular expenses from their gross revenues before being subject to taxation.[205] While this type of tax increases the administrative burden by requiring verification of claimed expenses and may decrease revenues because the mine may not operate at a profit for several years, it is more accurate in reflecting the producer's true ability to pay the tax. Thus, each form of severance tax is different in its ease of administration and the adequacy of the revenues it generates.

Despite their differences in form, coal severance taxes are all enacted to compensate the state for the exceptional costs incurred to support a burgeoning coal industry.[206] Each state's tax system reflects the state legislature's assessment of its revenue needs. The

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annual dividend to each adult of $1,000. It was the state legislature's determination that a disbursement of surplus revenues directly to residents would lessen the wastefulness of inevitable government spending. *See* Williams v. Zobel, 619 P.2d 448, 453 (Alaska 1980); *Coal Severance Tax Hearing, supra* note 1, at 111 (citing New York Times, June 15, 1980).

199. W. VA. CODE § 11-13-2a (1974 & Supp. 1981).

200. STATE TAXATION, *supra* note 151, at 1-13.

201. *Id.* at 7.

202. *Id.* at 9. *See* the North Dakota Coal Severance Tax, N.D. CENT. CODE § 57-61-01 (1981).

203. STATE TAXATION, *supra* note 151, at 9.

204. *Id.* at 10. Some coal mines are vertically integrated with the electric utilities: the utility produces the coal itself and then burns it in a generating plant located at the mouth of the mine. *See infra,* text at notes 277-91.

205. STATE TAXATION, *supra* note 151, at 12.

206. *See supra* text at notes 148-84.

state legislature is well-suited to appraise the public services actually provided, to hear competing arguments, and to decide whether a severance tax is an appropriate measure for that state. The autonomy of each state to tax its own coal producers is necessary to maintain the balanced federalism created by the Constitution.[207] Under the assumption that, in a pluralistic society, decisions made at the state level are more responsive to local wishes and are therefore better than centralized decisionmaking,[208] the state legislature is more cognizant of the costs necessary to provide the services required by increased coal development. The state legislature is more responsive to the desires of its constituents to control and manage the accompanying economic growth and it is more attuned to the responses of the competitive marketplace to prices reflecting state taxes.[209] For all these reasons, the state is the most appropriate entity to formulate a response to the difficult problems presented by increased coal production.

Nevertheless, it is clear that Congress may override state tax policies with its commerce clause authority.[210] Congressional interference with those state tax determinations would be warranted, however, only if the state action prohibited the flow of resources to out-of-state markets.[211] In addition to the strong position of the state legislature to tax the coal industry, federal involvement in coal severance taxation is especially inadvisable in light of congressional reticence to formulate a definitive coal policy and its ineffective attempts to regulate the coal industry. The following section will address the present federal role in western coal production.

B. The Federal Forum

The Constitution grants to Congress the power to "regulate commerce . . . among the several states."[212] That power has been interpreted to be complete,[213] but the commerce clause does not directly address the possibility of state interference with national commerce.

207. *See supra* text at notes 131-35.

208. *Federal Preemption of State Energy Policies, supra* note 6, at 98-99.

209. *See* Link, *supra* note 148, at 265-67.

210. *See supra* note 17; *infra,* text at notes 212-22.

211. 453 U.S. 609, 628 (1981).

212. The commerce clause, U.S. CONST. art. I, § 8, cl. 3.

213. The plenary power of Congress over national commerce was declared by Chief Justice Marshall in his decision of Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824), where he described the federal power to regulate commerce as "complete in itself, may be exercised to its utmost extent, and acknowledges no limitations, other than are prescribed in the Constitution." *Id.* at 9.

This silence creates ambiguity — is the commerce clause a device to balance the state and federal interests in national commerce or is it a means to establish the preeminence of national free trade?

An historical perspective does not provide a resolution of this ambiguity. The Constitutional Convention, divided between advocates of a strong central government and proponents of state sovereignty, refused to impose a categorical limitation on state action through the commerce clause.[214] Shortly thereafter, a strong federalist interpretation of the commerce clause was developed by Chief Justice Marshall in *Gibbons v. Ogden*.[215] The decision, which found a state charter in conflict with a federal coastal licensing law, established the federal government's absolute power over interstate commerce. This opinion, although strongly federalist, did not completely negate the states' role in regulating commercial activities. The Supreme Court continued to grapple with the tension present in the commerce clause's silence regarding state interference with commerce and fashioned various tests to evalute state actions: whether the regulation affected national or local subjects;[216] whether it was a regulation of commerce or an exercise of the police power;[217] or whether the regulation entailed a direct, substantial or an indirect, incidental burden on commerce.[218] As recently as 1980, the Supreme Court was still sharply divided on where federal powers under the commerce clause begin and end. In the case of *Reeves, Inc. v. Stake*,[219] Justice Blackmun's majority opinion called for restraint in interfering with state regulation of commercial activities based on "consideration of state sovereignty [and] the role of each state 'as guardian and trustee for its people' ".[220] Conversely, Justice Powell in his dissent took the position that "the Commerce Clause long has been recog-

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214. *See* Browde & DuMars, *supra* note 17, at 13, n.30.

215. 22 U.S. (9 Wheat.) 1 (1824).

216. Cooley v. Board of Wardens, 53 U.S. (12 How.) 299, 319 (1851) (upholding a state requirement that only local pilots navigate the Philadelphia harbor).

217. U.S. v. E.C. Knight Co., 156 U.S. 1 (1895), where the Court stressed it was "vital that the independence of the commercial power and of the police power, and the delimitation between them, however sometimes perplexing, should always be recognized and observed, for while the one furnishes the strongest bond of union, the other is essential to the preservation of the automony of the states as required by our dual form of government . . .". *Id.* at 13.

218. Munn v. Illinois, 94 U.S. 113 (1876), which stated, "[U]ntil Congress acts in reference to their interstate relations, the State may exercise all the powers of government over them, even though in doing so it may indirectly operate upon commerce outside its immediate jurisdiction." *Id.* at 135.

219. 147 U.S. 429 (1980) (upholding a state plan which limited sale of cement produced by the state's plant only to residents of the state).

220. *Id.* at 438.

nized as a limitation on [state] sovereignty, consciously designed to maintain a national market and defeat economic provincialism."[221] Thus, a precise delineation of state and federal powers under the commerce clause is still not possible in all possible circumstances in which a state-federal conflict may arise.

From the Court decisions rendered over the years, the conclusion arises that Congress' commerce clause power allows it to supplant state decisionmaking in the area of most economic activity arguably related to interstate commerce. Nevertheless, under the tenth amendment, Congress may not totally deprive a state government of the rightful maintenance of its sovereignty.[222] A constitutional distinction may exist between Congress' proper intervention in state decisionmaking in the area of interstate commerce and the federal government's improper requirement of state authorities to implement and enforce federal programs.[223] The autonomy of state government includes the freedom from federal coercion to enact specific laws and freedom from being subject to penalties. Congress may, however, directly impose regulation with federal administration, or it may invite the state legislature to enact a suitable implementation plan and administer it with state employees to avoid federal interference.[224] Congress arguably has power under the commerce clause to introduce a federal system of coal taxation which would complement its present efforts to increase domestic coal consumption.

Prior to the OPEC oil embargo of 1973, the federal government maintained a low profile in developing a national energy policy.[225] Regarding energy decisions as matters properly left to the private sector of the economy, the federal government intervened only to

221. *Id.* at 443.

222. *See supra* notes 17-18.

223. Three Court of Appeals cases were decided in this manner; the cases involved the Environmental Protection Agency's actions to enforce portions of the Clean Air Act, 42 U.S.C. §§ 1857-1857(1) (1976 & Supp. IV 1980). *See Federal Preemption of State Energy Policies Hearings, supra* note 6, at 161-62 (citing Dep't of Justice Memorandum: Constitutionality of the Energy Mobilization Board Proposal). *See* Brown v. EPA, 521 F.2d 827, 834-40 (9th Cir. 1975); District of Columbia v. Train, 521 F.2d 971, 992-94 (D.C. Cir. 1975); Maryland v. EPA, 530 F.2d 215, 225-28 (4th Cir. 1975).

224. 530 F.2d 215, 228 (4th Cir. 1975); *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 162 (citing Dep't of Justice Memorandum; Constitutionality of the Energy Mobilization Board Proposal (1979)).

225. NAT'L TAX ASS'N — TAX INST. OF AMERICA, PROCEEDINGS OF THE 72ND ANNUAL CONFERENCE, PREFERENTIAL TAX TREATMENT OF ALTERNATE ENERGY SOURCES AND ENERGY CONSERVATION 275 (1979) [hereinafter cited as PREFERENTIAL TAX TREATMENT OF ALTERNATIVE ENERGY SOURCES].

mandate decreased oil and gas prices, thereby artificially increasing demand.[226] In 1973, the nation found itself in the precarious position of relying on enormous energy imports, and the federal government began to assume a more dominant role in comprehensive policymaking for all phases of national energy use. Presently, supply and demand activities remain in the control of the private sector, but the federal government has assumed an active role in influencing fundamental market functions.[227]

As one aspect of its attack on foreign energy dependence, Congress acted to increase domestic coal production and consumption. As with other components of its energy strategy, however, the congressional approach to coal development has not been entirely rational. For example, although the nation's energy policy supposedly encourages increased coal development, no federal statute expressly outlines a comprehensive national coal policy.[228] Instead, Congress has enunciated its national coal policy in several statutes and has chosen to implement that policy through its administration of the federal lands leasing program, the federal system of tax incentives, and the federal regulation of interstate transportation.

1. Enunciation of a National Coal Policy

The national policy concerning coal development is not found in the substantive language of any federal statute;[229] instead, it exists only as a composite derived primarily from statements of findings and purposes of other energy-related statutes.[230] The producers and utilities in *Commonwealth Edison* cited many federal statutes[231] in support of their position that by increasing coal costs a severance tax frustrates a national policy which encourages coal consumption. Yet the only congressional pronouncements concerning coal production occur in legislative findings of over-dependence on foreign oil imports[232] and in statutory purposes to increase the development of domestic energy supplies.[233] Thus, the Montana Supreme Court in

226. *Id.*
227. *Id.*
228. *See infra* text and notes at notes 232-36.
229. *Id.*
230. *See infra* notes 232-33.
231. *Id.*
232. Energy Reorganization Act of 1974, 42 U.S.C. §§ 5801-5891 (1976 & Supp. IV 1980); Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §§ 751-760h (1976 & Supp. IV 1980); Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3342 (1976 & Supp. IV 1980).
233. Federal Nonnuclear Energy Research and Development Act of 1974, 42 U.S.C. §§ 5901-5917 (1976 & Supp. IV 1980); Energy Supply and Environmental Coordination Act of

Commonwealth Edison noted, "[h]ow then can any court determine that the effect of Montana's coal severance tax is to frustrate national policy, when no national policy can be discerned as a matter of law?"[234] State implementation of severance taxes in no way intrudes on the federal government's enunciated policies, as evidenced by the congressional statements. Beginning in 1973, Congress enacted legislation addressing the "national energy crisis"[235] and encouraging domestic energy resource development.[236] The Federal Nonnuclear Energy Research and Development Administration Act of 1974,[237] although not expressly referring to coal, presents the most specific statement of congressional intent to give priority to domestic energy production by finding that "domestic energy production in this country must approximately double by the end of this century . . . every form of energy [must] be put into use at the earliest possible moment, consistent with existing environmental laws, . . . new elements of energy production [must] be placed on line as quickly as possible."[238] This general assertion is not, however, a strong indication of congressional intent to increase coal production: it contains no suggestions on how to attain the goal of increased energy production; it never mentions the nation's coal resources as a solution; and it apparently expresses no opinion on the states' role in this energy development. Therefore, even if this general statement constitutes a national energy policy, it is too uncertain a statement to justify limiting the state's taxation power with respect to coal extraction.

The only congressional scheme specifically encouraging coal consumption is the Powerplant and Industrial Fuel Use Act of 1979 (PIFUA).[239] This Act states that coal is to be used as a primary energy source in lieu of natural gas or petroleum products and requires that electric powerplants and major fuel-burning installations convert to coal.[240] PIFUA also encourages the use of synfuels

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1974, 15 U.S.C. §§ 791-798 (1976 & Supp. IV 1980); Energy Policy and Conservation Act of 1975, Pub. L. No. 94-163, 89 Stat. 871 (1975 & Supp. IV 1980); Powerplant and Industrial Fuel Use Act of 1978, 42 U.S.C. §§ 8301-8483 (Supp. III 1979); Clean Air Act, 42 U.S.C. §§ 1857-1857(1) (1976 & Supp. IV 1980).

234. 615 P.2d 847, 861 (Mont. 1980).

235. Emergency Petroleum Allocation Act of 1973, 15 U.S.C. § 751(a)(3) (1976 & Supp. IV 1980).

236. *See supra* notes 232-33.

237. 42 U.S.C. § 5901-5917 (1976 & Supp. IV 1980).

238. Pub. L. No. 95-39, June 3, 1977. *See* LAW REPRINTS, *supra* note 26, at 136.

239. 42 U.S.C. §§ 8341-8483 (Supp. III 1979).

240. *Id.* at §§ 8341-8343 (Supp. III 1979).

derived from coal as well as the rehabilitation of railroad service and equipment necessary for the transportation of coal.[241] Interestingly, the Supreme Court in the *Commonwealth Edison* case pointed out that while the "only specific statutory provisions favoring the use of coal"[242] are found in PIFUA, the statute "clearly contemplates the continued existence, not the preemption, of state severance taxes on coal and other minerals."[243] Thus, Congress itself has acknowledged the state legislature's proper role in designing coal severance tax measures.

Despite these attempts to enunciate a national coal policy, the federal government has not provided any specific direction to accomplish its goal of increased domestic coal development. In fact, the federal government's implementation of a cohesive national coal policy has been ineffective and irregular.[244] In analyzing the alleged conflict between federal and state governments in the taxation of coal production, the salient factors are the federal government's unclear position regarding a national coal policy and the state's clear interest in a coal severance tax. From this perspective, it is apparent that a federally enunciated coal policy has not developed sufficiently to conflict with state interests in resource severance taxation.

2. Implementation of a National Coal Policy

It is within a scattered and haphazard framework that one must analyze the national coal policy and its interaction with state coal severance taxes. A coherent and equitable coal policy has not been effectuated by the federal regulatory agencies — the Bureau of Land Management, the Internal Revenue Service, and the Interstate Commerce Commission — which play a role in western coal development. This section will describe in more detail the federal government's involvement in coal development in order to determine the propriety of the federal legislative forum for dealing with the complexities of state taxation of resource production.

a. Leasing of Federal Lands

The Mineral Lands Leasing Act of 1920[245] establishes the supervisory structure to lease federal mineral lands. The Leasing Act and

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241. *Id.* at § 8301(b)(4)-(5) (Supp. III 1979).
242. 453 U.S. 609, 634 (1981).
243. *Id.*
244. *See infra* text at notes 245-304.
245. 30 U.S.C. §§ 181-209 (1976 & Supp. III 1979).

its provisions are crucial to the continued development of coal in the West because a substantial portion of western coal reserves are owned by the federal government.[246] This significant federal presence is an aspect unique to the western energy resource market — the grant of lands to the federal government was exacted as a dowry before the newly settled and industry-poor western territories were allowed to join with the Union.[247] The eastern, midwestern, and southern states are not encumbered by such an extensive federal ownership of state lands and resources.[248]

The Mineral Lands Leasing Act was enacted only after many years of heated debate.[249] The early 1900's saw many western Congressmen fighting vehemently for the return of federal lands to the states either by sale to private interests or by reasserting the sovereignty of the states originally holding the lands. Nevertheless, the opposing view prevailed in 1920, and federal ownership in western lands was retained for the benefit of the entire country.[250] Unfortunately, the arguments made in 1916 remain valid — federal control of mineral-rich lands results in "the perpetual bureaucratic domination that [is] exercised from Washington in their administration and control".[251] The western coal-producing states are completely dependent upon

246. Approximately 60 percent of all western coal reserves are owned by the federal government. COAL COMPETITION, *supra* note 24, at 10,692 (1981). Actual federal control is even greater, however, because of land ownership patterns, with an additional 20 percent of reserves dependent on the availability of complementary federal coal for its production. *Id.* at 10,700; [1981] ENERGY USERS REP. (BNA) 387:24-25.

247. The federal government owns over 75 percent of Nevada's and Idaho's land. Montana has 28 percent of its land in public hands, with 75 percent of its coal under federal control. *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 85 (statement of Mont. Att'y Gen. Mike Greely).

It should be noted here that Alaska was in a particularly good bargaining position to enter the Union — able to retain the right to 90 percent of all royalties and revenues from federal lands in the state. *Coal Severance Tax Hearing, supra* note 1, at 49 (statement of N.M. U.S. Sen. Pete Domenici); *id.* at 67 (statement of Minnesota U.S. Sen. David Durenberger).

248. *Coal Severance Tax Hearing, supra* note 1, at 88 (quoting Energy: Limiting State Coal Severance Taxes, report by the Congressional Research Service (1980)). In states without federal ownership of mineral lands, private parties are free to lease and produce mineral reserves in a healthy competitive market subject only to the strictures imposed by the state itself. *See infra* text at notes 250-54.

249. Hearings began in 1914 to determine if public lands should be retained by the federal government and, if so, how they were to be administered. *See* Montana District Court opinion Commonwealth Edison Co. v. Montana, *reprinted in* LAW REPRINTS, *supra* note 26, at 259-60 (unpublished opinion) (citing H.R. REP. NO. 668 (Part 2) 63d Cong., 2d Sess. (1914); H.R. REP. NO. 17 (Part 2) 64th Cong., 1st Sess. 8 (1916)).

250. Pub. L. No. 146, 41 Stat. 437 (Feb. 25, 1920).

251. H.R. REP. NO. 17 (Part 2), 64th Cong., 1st Sess. 8 (1916) (minority views). *See* Brief for the United States as Amicus Curiae at 10 n.5, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 722.

pletely dependent upon the Bureau of Land Management for the continued leasing of its land, the equitable pricing of those leases, and the efficient oversight of the rights granted through the leases.[252] The Bureau of Land Management alone determines when and where leases will be offered. Federal regulation sets the charges for rentals, royalties, and bonuses required to lease public lands.[253] This federal control of leasing rights over large areas of western states necessarily intrudes on those states' supervision of resource development within their borders.[254]

Under the Mineral Lands Leasing Act, the coal-producing states share all revenues[255] from federal coal leases with the federal government.[256] The states in which coal mining occurs receive 50 percent of all money collected from sales, bonuses, royalties, and rentals of the public lands within their borders.[257] The money received by each state is spent as its legislature directs, giving priority to those areas socially or economically affected by development of the mineral leases which generate the revenue. The funds allocated to such impact areas are used for planning, construction, and maintenance of public facilities and provision of public services.[258] The remaining 50 percent of the federal revenues from public lands is disbursed by the federal government. Forty percent of the federal share becomes part of a reclamation fund under the Reclamation Act of 1902.[259] These funds are restrictively allocated — only designated states participate and only to the extent necessary to fund the construction and maintenance of irrigation projects to reclaim arid and semi-arid regions.[260] The final 10 percent of federal leasing revenues goes directly into the United States Treasury.[261]

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252. 30 U.S.C. §§ 181-209 (1976 & Supp. IV 1980).

253. *Id.* The Secretary of the Interior promulgates regulations.

254. *See* Plummer, *The Federal Role in Rocky Mountain Energy Development,* 17 NAT. RESOURCES J. 241 (1977).

255. The federal government receives revenues under the Mineral Lands Leasing Act in three principal forms: bonuses, royalties, and annual rental charges for the acreage leased. One study concluded that rates charged under the Mineral Lands Leasing Act of 1920 are considerably lower than charges imposed by private land owners. *See* Morgan & Olson, *Nonneutral Features of Energy Taxation,* 20 NAT RESOURCES J. 853, 874 (1980). At present, bidders compete according to the amount of bonus they will pay; the royalty is fixed at a minimum rate of 12 1/2 percent of market value of surface-mined coal; the annual rentals are prescribed by regulation. 43 C.F.R. 3473.3 (1981); 30 U.S.C. § 207 (1976).

256. 30 U.S.C. § 191 (1976).

257. *Id.*

258. *Id.*

259. 43 U.S.C. §§ 391-391a-1 (1976).

260. *Id.*

261. 30 U.S.C. § 191 (1976).

The administration of the Mineral Lands Leasing Act has been less than effective. Due to the long-term nature of the leases[262] and the unforeseen increase in coal production in the 1970's, the federal government found itself holding leases extremely favorable to the lessees, in some cases with an annual rental charge of only $1 per acre.[263] In response to this situation, the federal government imposed a moratorium in 1971 on the leasing of new coal lands.[264] This moratorium was also designed to stop energy companies from leasing tracts at minimal cost and waiting for coal prices to rise before beginning production.[265] Many of the original Act's financially archaic provisions were corrected when Congress amended the Act in 1975.[266] Although the amendments were designed to produce revenues which reflected the true market values of the land, the moratorium on new leases continued for ten years. Exceptions to the leasing ban were allowed only to avoid a mine shutdown in the case of a continuous seam running onto unleased federal lands or to prevent the loss of federal coal which might occur if a producer was forced to mine around unleased reserves.[267] The inefficient management of federally owned land, leading eventually to a complete moratorium on leasing, contradicts the assertion that a national policy to encourage coal production has been effectively established.

The result of the federal government's domination of leasing practices has been the creation of a de facto monopoly on federal coal lands.[268] Competition among the coal producers is discouraged

262. Federal coal leases are granted for 20 year terms with extensions available so long as commercial quantities of coal are produced. 30 U.S.C. § 207 (1976).

263. *See infra* note 275.

264. *See* [1980] ENERGY USERS REP. (BNA) 376:16.

265. *Id.* at 16-17. The moratorium was lifted on April 28, 1982 by the coal lease sale of 13 tracts of land in Montana and Wyoming involving more than 1.5 billion tons of coal. [1982] ENV'T REP. (BNA) CURRENT DEVELOPMENTS 169.

266. Under the original 1920 Act, land was not always leased on a competitive basis and therefore did not always yield the revenues available in a competitive system. The Secretary was authorized to issue prospecting permits and if the permittee demonstrated the existence of coal, he was entitled to lease the tract on a noncompetitive basis. 30 U.S.C. § 201(b) (1970). In addition, the Secretary was entitled to waive, suspend or reduce the rental or minimum royalty, and reduce the production royalty, whenever necessary to promote development. 30 U.S.C. § 209 (1970). *See* Brief for the United States as Amicus Curiae at 6 n.3, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 718. The Amendments of 1975 raised royalty charges, now 12 1/2 percent of value, from a minimum of 5 cents per ton; rental charges are now prescribed by regulations; competitive bidding is required in all cases, *see* 45 Fed. Reg. 84928 (1980); and a license system for exploration was established which gives no right or preference to a subsequent lease, *see* 43 C.F.R. 3430.0-7 (1981).

267. COAL COMPETITION, *supra* note 24, at 10,701 n.12 (1981).

268. [1981] ENERGY USERS REP. (BNA) 419:1299 (based on an American Enterprise In-

because private lessors do not control large enough blocks of land to make mining profitable; coal prices are inflated by limiting competition to the few private leases available.[269] Futhermore, patterns of federal coal leasing present a disturbing picture. In the 1950's, individuals and independent corporations held 72 percent of all federal lands under lease — that figure is now 31 percent.[270] Almost half of the federal coal acreage currently under lease is held by subsidiaries of oil, gas, nuclear, and electric utility conglomerates.[271] The federal government's involvement in western coal development has, thus, tended to result in the concentration of ownership and economic benefits in large corporate holdings.[272]

The Mineral Lands Leasing Act of 1920 established the federal government's power to control and lease a substantial portion of western coal reserves. The revenue allocation provisions of the Act, however, do not adequately compensate the producing state for the loss of control over its mineral rich land.[273] The state loses a large portion of its potential property tax base because no property tax is paid on federal lands.[274] In addition, the 50 percent share of federal leasing revenues which goes directly to the coal-producing state does not currently produce a large amount of revenue because the majority of federal leases remain grossly undervalued.[275] Because the 40 percent restrictive allocation to the reclamation fund may not be expended by the state as it deems necessary,[276] those revenues are of little use to the state in mitigating the impacts of coal development accompanying federal leasing. Furthermore, the ten-year morato-

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stitute study).

269. [1980] ENERGY USERS REP. (BNA) 380:9.

270. [1981] ENERGY USERS REP. (BNA) 398:566. *See also* COAL COMPETITION, *supra* note 24, at 10,687.

271. [1981] ENERGY USERS REP. (BNA) 398:566.

272. For a statement concerning the control of these large corporate conglomerates over the coal industry see the *Cartel Restriction Act: Hearings on H.R. 4661 before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce* 9th Cong., 2d Sess. 126, 136 (June 26, 1980) (statement of S. David Freeman, Chairman of the Board of TVA).

273. In 1979, Montana received $555,000 from its one-half of federal receipts under the Act. Yet the state's Coal Board, which is responsible for assisting those areas affected by coal development, must spend nearly ten times that each year. *Commerce Clause Hearings, supra* note 9, at 153 (statement of Mont. State Sen. Thomas E. Towe).

274. *See supra* note 182.

275. The annual rental charge was restricted under the 1920 Act to a minimum of 25 cents per acre in the first year and not less than $1 per acre after five years. 30 U.S.C. § 207 (1976); Plummer, *supra* note 254, at 242; Moyer, *The Role of Coal: Problems and Policies,* 18 NAT. RESOURCES J. 761, 768-69 (1978).

276. 43 U.S.C. §§ 391-391a-1 (1976).

rium on federal leasing of mining areas in effect destroyed the revenue-producing potential of the remaining unleased land. As a consequence of all these factors, the state receives much less revenue under the Mineral Lands Leasing Act than it would if the land were leased directly by the state. Both the explicit language of the Act and its operation encourage the imposition of a state severance tax to ensure the receipt of adequate compensation for the state's mined resources.

b. Taxing Electric Utilities

Electric utilities consume most of the coal produced in the United States.[277] Not only do they consume coal — the electric utilities are involved in its production as well. At least 30 percent of all coal mined on federal land is produced by utilities.[278] This phenomenon of production by the consumer is known as "vertical integration."[279] The coal mined is used as fuel for a generating station located at the mine mouth. The electricity generated in coal-producing states is then transmitted across power lines to energy-importing states.[280] Vertical integration is encouraged by tax policies which give utilities economic advantages over independent coal producers.

The federal government's special tax treatment of electric utilities affects the coal industry in two ways. First, the tax advantages afforded utilities lessen their incentive to enter long-term supply contracts with independent coal producers; yet, long-term supply contracts increase coal companies' efficiency and decrease coal prices.[281] Secondly, federal tax policies encourage the utilities' reliance on their own coal production, which appears to be less efficient than comparable independent coal mines and may cause higher prices.[282] Thus, federal taxation decisions are largely responsible for the electric utility industry's position as a major coal producer, as well as the major coal consumer.

Most electric utilities are publicly regulated monopolies and, as such, are allowed certain tax advantages by the Internal Revenue

277. The electric utility market accounts for 72% of coal consumption in the United States. *See* Moyer, *supra* note 275, at 765.

278. The utilities held 21 percent of the federal coal acreage under lease in 1979. [1981] ENERGY USERS REP. (BNA) 398:566. In addition, energy companies, natural gas pipeline companies, and smaller oil and gas companies together held 31 percent of all outstanding leases and produced 29 percent of the coal mined in 1979. *Id.*

279. STATE TAXATION, *supra* note 151, at 10.

280. *See* Link, *supra* note 148. Conversation with Bill Schwarzkoph, Reclamation Supervisor, Western Energy Company, Colstrip, Montana (Jan. 8, 1982).

281. COAL COMPETITION, *supra* note 24, at 10,695.

282. *Id.*

Service. Publicly owned utilities which use no private investment capital are exempt from federal income taxation.[283] In addition to that favored status, some of these utilities may also benefit from tax-exempt municipal bond financing[284] which permits their capital expenditures to be financed at lower interest rates than those available to their coal-producing competitors. Thus, the Internal Revenue Service places these public utilities in a favorable competitive position to enter the coal industry and to produce their own coal.

The electric utilities which are privately owned are not exempt from federal income taxation. They do, however, benefit substantially from a federal tax policy[285] which allows utilities to collect from their consumers federal income taxes which are not paid. These "phantom taxes" occur through the operation of accelerated depreciation deductions,[286] depletion allowances,[287] and investment credits[288] which offset the utilities' federal income tax liabilities. Unfortunately, the utilities' tax reductions are not passed on to their consumers.[289] The actual benefits to the utilities are enormous. In 1978, the nation's 100 largest power companies charged their con-

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283. The tax exempt status of public utilities, as defined in I.R.C. § 247(b)(1) (1981), is provided by I.R.C. § 115(1) (1981).

284. In addition to their tax exempt status, some utilities also benefit from tax exempt municipal bond financing. *See* Morgan & Olson, *supra* note 255, at 866 (citing I.R.C. §§ 75, 115 (1981)).

285. This federal tax policy involves the tacit approval of state utility commissions' decisions permitting the utilities to charge their consumers for taxes not paid.

286. The Economic Recovery Tax Act of 1981 established the Accelerated Cost Recovery System which permits recovery of capital costs for tangible depreciable property over periods of time significantly shorter than the useful life of that property. For public utilities, property may be depreciated over a 5-, 10-, or 15-year period, depending upon the type of property. *See* I.R.C. § 167 (1982). This accelerated depreciation provides large deductions to property-owning utilities which reduce their federal income tax liabilities accordingly.

287. Depletion allowances compensate the mineral owner for the gradual reduction of the natural resource reserve. I.R.C. §§ 611-613A (1981). Morgan & Olson, *supra* note 255, at 862; NAT'L TAX ASS'N TAX INST. OF AMERICA, PROCEEDINGS OF THE 72d ANNUAL CONFERENCE, TAXATION AND NATURAL RESOURCE PRODUCTION TRENDS, 294, 304 (1979) [hereinafter cited as TAXATION AND NATURAL RESOURCE PRODUCTION]. The deductions provide a major benefit to the coal industry by accelerating the recovery of capital costs expended to develop the depletable property. *See* Treas. Regs. §§ 1.611-1.613 (1982).

288. I.R.C. §§ 46-48 (1981).

289. State utility commissions determine what expenses are passed through to consumers. The utility company's federal income tax liability can be handled by either of two approaches: the tax liability can "flow through" to the consumer — an approach where both burdens and benefits go to the consumer; or the tax liability can be "normalized" — where the effective rate taken from tax tables is applied to projected income yielding the amount to be paid by the consumer. This latter approach does not allow the consumer to benefit from the utility's tax deductions and credits, resulting in "phantom taxes." Conversation with Steven Ferrey, Nat'l Consumer Law Center, Boston (Feb. 23, 1982).

sumers $3.5 billion for federal income taxes; the utilities paid only $797 million in taxes to the federal government; they kept $2.74 billion.[290] Consequently, both publicly-owned and privately-owned electric utilities benefit from federal tax policies which improve the utilities' position to mine coal.

The electric utilities' involvement in western coal production is significant and results in part from federal tax policies. The special tax treatment afforded publicly-owned utilities creates an imbalance in the marketplace by giving utilities a competitive advantage in the production of coal. The unusual economic position of privately-owned utilities creates inequity in the marketplace, where consumers pay higher energy prices through phantom taxes. While the utilities have actively lobbied[291] against state coal severance taxes as imposing an intolerable burden on their consumers, these same utilities continue to benefit from federal tax advantages which increase consumers' energy costs. Federal tax policies — the tax exempt status of public utilities and the acceptance of phantom taxes — undermine the argument that the national energy policy seeks minimal energy costs and maximum production efficiency, particularly to encourage the consumption of coal. These federal tax choices negate the allegation that state severance taxes increase energy costs to the extent that a conflict arises with a national coal policy.

c. Regulating Railroad Rates

The railroads' largest customer is the western coal industry.[292] The Interstate Commerce Commission regulates rail transportation[293] and presently permits freight rates to comprise up to 75 percent of the delivered price of coal.[294] As an example, Montana coal

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290. *Coal Severance Tax Hearing, supra* note 1, at 589-91 (statement of David Alberswerth, Western Organization of Resource Councils); *id.* at 325 (statement of Mont. State Sen. Thomas E. Towe).

291. The National Coal Consumers Alliance (NCCA) has spent approximately $100,000 per month during the last two years to limit state coal severance taxes. *Coal Severance Tax Hearing, supra* note 1, at 170 (statement of the Wyoming Outdoor Council). In Montana, $800,000 was spent for lobbying to limit the coal severance tax rate. *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 77 (statement of Mont. Att'y Gen., Mike Greely).

292. Coal: Transportation Hangups Cause Headaches as Industry Tries to Increase Exports, [1980] ENERGY USERS REP. (BNA) 376:21.

293. 49 U.S.C. §§ 10701-10786 (Supp. IV 1980).

294. On a per ton basis, transportation costs dwarf the state's severance tax burden. Montana's severance tax runs approximately $2.45 per ton, while the cost of transporting that ton to Detroit is $17.25. During 1980, the increase alone of railroad rates nearly equalled the entire revenues from the Montana severance tax. *Commerce Clause Hearings, supra* note 9, at

costs $35 per ton when delivered to Austin, Texas. Of that amount, $28 is the freight charge and only $1.41 is attributable to the coal severance tax.[295] Moreover, the Interstate Commerce Commission has been liberal in granting rate increases. In one year, the increase in freight rates alone exceeded the *entire revenue* from Montana's coal severance tax.[296] The Interstate Commerce Commission is responsible for administering the interstate transportation system in accordance with federal policy. The large proportion of coal prices attributable to rail freight rates indicates a policy by the Interstate Commerce Commission which hampers coal consumption far more than a state's coal severance tax. Such Interstate Commerce Commission regulation provides further support for the contention that there is no coherent national policy on coal with which a state's coal severance tax could conflict.

A possible by-product of the federal regulation of rail rates is the increased economic role of a limited number of railroad companies in the western states' resource market.[297] For example, Burlington Northern, Inc. moves almost all of Montana's coal.[298] It is the largest employer in Montana, with over 8,500 employees.[299] Burlington Northern is also the largest private land holder in Montana — combined with other railroads, it owns approximately 15 percent of Montana land, and it holds the mineral rights to much more.[300] It is interesting to note that more than 16 billion tons of western coal are owned by the railroads.[301] Federal acquiescence to the commanding presence of the railroads in the coal industry illustrates a disturbing aspect of federal energy policy: that a state's resources will be controlled, priced, and sold by out-of-state corporations which do not fully consider that state's best interests. Therefore, state taxation of resource taxation is indirectly encouraged, at least as a means to retain a portion of the state's lost economic base.

Federal regulation of the coal industry has not consistently resulted in increased coal production or consumption. The morato-

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100 (statement of N.D. U.S. Rep. Byron L. Dorgan). *See* Church, *supra* note 9, at 272.

295. *Coal Severance Tax Hearing, supra* note 1, at 13 (statement of Mont. U.S. Sen. John Melcher).

296. *Commerce Clause Hearings, supra* note 9, at 100 (statement of N.D. U.S. Rep. Byron L. Dorgan); Link, *supra* note 148, at 266.

297. Coal: Transportation Hangups Cause Headaches as Industry Tries to Increase Exports, [1980] ENERGY USERS REP. (BNA), 376:19-22.

298. *Coal Severance Tax Hearing, supra* note 1, at 109 (citing Minneapolis Star, June 10, 1980).

299. *Id.*

300. *Id.*; [1980] ENERGY USERS REP. (BNA) 380:9.

301. *Id.*

rium on new leases of federal coal lands, the tax advantages provided to electric utilities, and the significant charges and control permitted to the railroad industry all evidence federal involvement in the coal industry which has little to do with increasing the production of this natural resource. Federal involvement appears to result only in fewer companies controlling more coal than ever before with greater cost to the consumer.[302] Under federal supervision, the coal industry's competitive marketplace is becoming limited to large utilities, energy companies, and the railroads.[303] Thus, federal legislative action in this area does not indicate a national energy policy exists which is sufficient to preclude state taxation. Nevertheless, concerns that the exclusive state control of energy resources would fracture the market for resources on which the entire nation depends are not unreasonable. Such concerns, however, do not undermine the apparent suitability of the state legislative forum to set resource taxation schemes. Without a clear and cohesive national policy, federal intervention in the state taxation of its energy resources raises fears for national unity.[304] The next section presents a resolution of the dilemma — who should decide the appropriate level of energy resource taxation?

C. Resolution: Who Should Develop Resource Taxation?

The proper forum for determining equitable levels of coal severance taxes is the state legislature. The state legislature is the more capable government body because it is closer to the "numerous and competing economic, geographic, demographic, social and political considerations that must inform a decision about an acceptable rate or level of state taxation."[305] The state government, along with local and federal governments, creates the public policy which shapes the pace and direction of energy resource development; but it is the national marketplace which ultimately determines the viability

302. *See supra* text at notes 268-72, 283-91, 297-301.

303. *Id.*

304. "In his recent book, *The Third Wave,* author Alvin Toffler cites the nation's energy crisis as a catalyst that could lead to a breakdown in national unity." *Coal Severance Tax Hearing, supra* note 1, at 98 (citing U.S. News & World Report, June 16, 1980).

In addition, there exists a generally-held view that "[w]hen serious problems do arise, it is usually the federal government, not the state government, which is responsible." *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 12 (statement of Joseph E. McElwain, Chairman of Montana Power Company and Representative of the Western Regional Council). *See also* [1980] ENERGY USERS REP. (BNA) 376:15.

305. Commonwealth Edison Company v. Montana, 453 U.S. 609, 628 (1981).

of that public policy.[306] Excessive coal severance tax rates would be precluded in a competitive marketplace.

The Montana state legislature, in particular, enacted its 30 percent coal severance tax only after fully considering the possible competitive disadvantages which would result.[307] Assertions that the level of Montana's tax has inhibited coal production are refuted by increased production levels and recent market demand. Production increased 31 percent in 1980 to more than 34 million tons.[308] In addition, a long-term contract has been entered recently for 250 million tons of Montana coal; it is the largest coal contract in the history of the industry.[309] In this context the rate of taxation acceptable in the marketplace is likely to be closer to the socially optimal price of coal than would be a federally regulated price.[310]

Despite the marketplace's acceptance of Montana's coal severance tax, the political system has not been as tolerant. Congress has considered several bills to place a percentage limit on coal severance tax rates.[311] Regulated prices often serve to provide energy resources to the nation's consumers at less than cost;[312] such federal intervention to decrease energy prices would encourage consumption. The artificially induced reliance on cheap coal, however, could result in the waste of a nonrenewable resource, exploitation of a unique region's environment, and the demise of an American heritage known as "the West." Recent federal laws have stressed the importance of allowing energy prices to rise, both to reflect true market prices of the resources and to allow the overall costs of energy production to be internalized in energy prices.[313] Alfred Kahn, in congressional testimony, explained:

> it is widely recognized that economic efficiency alone requires that all pertinent social costs, internal and external, be levied in

306. *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 33 (statement of Robert Hall, Representative of Western Governors' Policy Office).

307. Montana Coal Council Report, *supra* note 43.

308. *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 78 (statement of Mont. Att'y Gen., Mike Greely).

309. *Id.*

310. *Production Trends,* in TAXATION AND NATURAL RESOURCE PRODUCTION, *supra* note 287, at 304; *Commerce Clause Hearings, supra* note 9, at 164 (statement of James C. Rosapepe, Multistate Tax Commission).

311. The 96th Congress saw the introduction of four severance tax cap measures — S. 2695, H.R. 6625, H.R. 6654 and H.R. 7163. The 97th Congress repeated the process with S. 178 and H.R. 1313.

312. PREFERENTIAL TAX TREATMENT OF ALTERNATE ENERGY SOURCES, *supra* note 225, at 275.

313. H. REP. NO. 218, 95th Cong., 1st Sess., *reprinted in* [1977] U.S. CODE CONG. & AD.

> one way or another on the particular acts of production or consumption causally responsible for them. This will eliminate the subsidization; by confronting consumers with prices reflecting the full social costs of supplying them, it will ensure that no activities will be carried on whose total incremental costs exceed their benefits. And it will ensure, also, that production will be carried on by methods that minimize total costs, rather than only those costs that happen to fall on the producer.[314]

Federal attempts to override state severance taxes are inappropriate because coal prices would be prevented from rising to reflect true cost.

The public policy rationale of increased coal production at a decreased cost currently used to justify federal intervention in state severance tax systems correlates with the general deemphasis of environmental concerns and the growing attention paid to energy and economic needs.[315] Extreme care must be taken to ensure that the renewed national emphasis on coal does not result in the costly sacrifice of putatively "worthless" undeveloped prairie lands to economically "worthwhile" strip-mining. Such is the responsibility of both the federal and state governments in implementing a unified coal policy.

IV. ALTERNATIVES

Notwithstanding the foregoing conclusion that state-imposed coal severance taxes are an acceptable means of compensating the state for costs of increased development, a hue and cry has arisen from the energy-importing states attacking the validity of such taxation. Perhaps the conflict is due to the focus on coal as the salvation of the nation's energy woes;[316] perhaps because the percentage measure of the tax is higher for coal than other energy resources;[317] perhaps the

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NEWS 593, 599 (Surface Mining Control and Reclamation Act); H. REP. NO. 294, 95th Cong., 1st Sess., *reprinted in* [1977] U.S. CODE CONG. & AD. NEWS 1077, 1150-51 (Clean Air Act Amendments of 1977). *Cf.* S. REP. NO. 141, 95th Cong. 2d Sess., *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 7660, 7679 (Public Utilities Regulatory Policies Act). *See* Amicus Curiae Brief of the Environmental Defense Fund, Natural Resources Defense Council, and Sierra Club at 151-16, Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), *reprinted in* LAW REPRINTS, *supra* note 26, at 607-08.

314. *Executive Branch Review of Environmental Regulations: Hearing before the Subcomm. on Environmental Pollution of the Senate Comm. on Environmental and Public Works,* 96th Cong., 1st Sess., 406 (statement of Alfred Kahn, Chairman of the Council on Wage and Price Stability).

315. *Federal Preemption of State Energy Policies Hearings, supra* note 6, at 136 (Appendix, paper of Prof. Daniel H. Henning).

316. *See supra* text at note 37.

317. *See supra* text at note 31.

federal ownership of western coal provides a more persuasive vantage point for the utility companies' lobbying efforts;[318] or perhaps the sparse population of the western states provides less of an obstacle to economic pressures.[319] In any event, the imposition of coal severance taxes has become the rallying point for such cries from the energy-importing states as "economic war between the states" and "American OPEC," and such retorts from the energy-producing states as "neocolonial exploitation" and "let them freeze in the dark."[320]

The present polarization of the country's energy-producing and energy-importing regions can be ameliorated by implementation of one or more of three alternatives which will be detailed in the following sections. The purpose of all three proposals is to effect a geographic redistribution of energy resource revenues, premised on the assumption that it is to both regions' advantage to minimize the losses and hardships due to energy costs.[321] The first, and most encompassing recommendation is the creation of an Interstate Council into which every state will pool a portion of its resource revenues. These revenues will then be disbursed to those states requiring special assistance. The second alternative looks back to the New Deal days of the Reconstruction Finance Corporation in advocating that the provision of low-cost financing be made available to those energy importing localities in difficult financial straits. Under this plan, the lending would be done by the energy-producing states from their resource revenues, rather than by the federal government. The third proposal is addressed to the federal government and concerns the reformulation of current revenue sharing computations in order to more equitably reflect the state's need for federal assistance.

A. Interstate Pooling of Revenues

The first alternative to the present conflict over energy resource taxation centers on the creation of a non-federal, Interstate Council.[322] This Council would be composed of a representative from

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318. *See supra* text at notes 246-48, 291.

319. *See supra* text and notes at notes 143-45.

320. *Coal Severance Tax Hearing, supra* note 1, at 97-98 (citing U.S. News & World Report, June 16, 1980); *id.* at 94 (citing Washington Post, April 20, 1980).

321. If an energy-importing state becomes financially insolvent, the energy-producing state will also be harmed by decreased sales and increased defaults.

322. This type of proposal was first presented in 1979 and 1980 by two Canadian economists, Anthony Scott and John F. Helliwell, working under the University of British Columbia's Programme in Natural Resource Economics, financed by the Social Sciences and

every state[323] and would work cooperatively with the states in the areas of resource taxation and natural resource management. It would perform two broad functions: the collection of a portion of each state's resource revenues; and the promotion of agreement on pooling these revenues to be shared among the states.[324] The Council would provide cohesiveness of action in the area of resource taxation without assigning this troublesome area to the federal government. It would keep state resource revenues discrete from federally administered assistance programs; it would retain the state's autonomy over its own resource base[325] as complementary to federal energy policy.

Admittedly, a non-federal Interstate Council of this kind is all but unknown in North America. Such a body has been proposed in Canada to deal with the provincial revenues of Alberta, Saskatchewan, and British Columbia.[326] In addition, West Germany has long had a system of interstate sharing in which the strong junior governments bypassed the central government to establish their own interstate financial linkages.[327] The West German Bundesrat is illustrative of the proposed Council in its development of a transfer mechanism which is separate from and smaller than other economic measures in which the German federal government is involved.[328] An American Interstate Council could operate on a much more restricted level, limiting its activities to the equitable allocation of resource revenues.

The purpose of interstate pooling of resource revenues would be to redistribute geographically some of the energy-producing states' resource revenues. The procedural aspects of the Council's operations are sketched as follows. All states would contribute a certain portion of their total resource revenues to a separate interstate pool.[329] Revenues from all natural resources would be pooled, in-

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Humanities Research Council of Canada. J. F. HELLIWELL, RESOURCES PAPERS (1980); A. SCOTT, RESOURCES PAPERS (1980).

323. Each state's tax commissioner would be specially qualified to serve on such a Council.

324. *See* A. SCOTT, DIVIDED JURISDICTIONS OVER NATURAL RESOURCE REVENUES, RESOURCES PAPER NO. 52, at 25 (June, 1980).

325. Some would argue that operation of the Council would unacceptably derogate state autonomy to other states. Nonetheless, cooperation among the states has been evidenced in Congressional coalitions, regional commissions, and governors' councils. Faced with federal meddling into state tax rates, the states foreseeably might be willing to submit to a sister state. *See* A. SCOTT, *supra* note 324, at 30.

326. *See supra* note 322.

327. A. SCOTT, *supra* note 324, at 27.

328. *Id.* at 33-34.

329. Resource revenues: (a) are used to lower the price of the resource to consumers below

cluding non-mineral renewable resources.[330] The Interstate Council would determine not only the proportion of revenues to be pooled, but the average rate of tax for each resource as well. The pooled revenue could be divided annually based upon interstate negotiation reflecting such factors as state need, per capita personal income, and population.[331] The fund would break even on a year-to-year basis and would serve only to redistribute a portion of the significant state income from resource development.[332]

The role of the resource revenue Council would be to exercise an increased level of control over the states' relationships with each other. Arguably, that control is specifically granted to Congress by the commerce clause; however, use of that power is also discretionary. In the troublesome case of state taxation of energy resources, it may well be preferable for Congress to allow the states to "even things out" among themselves through a separate decisionmaking body. Congress' decisionmaking machinery is often unwieldy and its political process is often incapable of providing the flexible maneuvering required of any economic redistribution. The Council, on the other hand, would be composed of individuals familiar with their state's revenue needs and tax systems.[333] Such an interstate body would be well-equipped to consider requests for assistance and would be able to compromise.

The energy-importing states can be expected to be willing participants to such a pooling of resource revenues. The energy-producing states will require a number of incentives in order to induce them to part with rightfully gotten gains. First, only a portion of their resource revenues would be pooled. The computation of that portion would be based on a surplus, a residue after all necessary costs of resource development and replacement are met. Therefore, the voluntary pooling of revenues would apply only to excess receipts.[334] The energy-producing states' willingness to accept a large transfer of resource revenues may also be premised on the preference of voluntary action as opposed to federal control of those

its expected market level; (b) flow into the dividends of operating companies' shareholders or the wages of the companies' workers; and (c) become public revenues to the extent royalties, fees, and taxes are paid from them. A. SCOTT, *supra* note 324, at 19-20.

330. Non-mineral renewable resources would include production of timber, which has a "severance" tax levy in Virginia. VA. CODE § 58-939 (1974 & Supp. 1981).

331. A. SCOTT, *supra* note 324, at 20.

332. J. F. HELLIWELL, *Taxation and Energy Policy,* RESOURCES PAPER NO. 47, 10 (January, 1980).

333. *See supra* note 323.

334. A. SCOTT, *supra* note 324, at 18-19.

same revenues.[335] In addition, all producing states are cognizant of the boom-and-bust cycle in resource development. They realize that the present increased level of revenues will not continue indefinitely. In future years, the states with later-developing resource bases will be sharing their increased revenues.[336] Voluntary participation in a revenue pooling system might also mitigate another phenomenon related to resource development — financially-induced migration.[337] For an example, providing financial assistance to the Northeast could possibly reduce the large numbers of people migrating to the Southwest in search of better economic conditions. Moreover, the federal government could provide both regulatory and tax incentives to participation in the pooled fund.[338] It might even agree to include its share of royalty receipts from federal lands in the Council's funds.[339] Such amounts are negligible under the Mineral Lands Leas-

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335. Testimony before a Congressional hearing examined the adverse precedential effect of federal interference in state tax systems:

> The precedent is overwhelming. If Congress can reduce the coal tax in Montana to produce cheaper electricity for the rest of the Nation, it can reduce the oil severance tax in Texas and Louisiana to produce cheaper gasoline, the wood products tax in Oregon to produce cheaper lumber, the iron ore tax in Minnesota to produce cheaper steel products, and the single business tax in Michigan to produce cheaper automobiles. It isn't very far from these to a law that would limit the sales tax in Illinois or the income tax in Iowa to allow farmers to grow slightly cheaper corn. Or a law that would limit the property tax in New York to allow larger dividends from corporations with large corporate headquarters in New York City.

Federal Preemption of State Energy Policies Hearings, supra note 6, at 45 (statement of Mont. State Sen. Thomas E. Towe).

336. Those increased revenues may be substantial as reserves dwindle and prices escalate. The eastern seaboard has not built a new refinery since 1957, yet offshore oil and gas exploration is beginning. Ohio prohibits development of Lake Erie, yet an estimated reserve of 650 billion cubic feet of natural gas is being developed by Canada with over 300 wells drilled across the Lake. NAT'L TAX ASS'N–TAX INST. OF AMERICA, PROCEEDINGS OF THE 72d ANNUAL CONFERENCE, LOUISIANA'S FIRST USE TAX, 197 (1979) [hereinafter cited as LOUISIANA'S FIRST USE TAX].

337. J. F. HELLIWELL, *The Distribution of Energy Revenues Within Canada: Functional or Factional Federalism*? RESOURCES PAPER NO. 48, at 12,17 (Feb. 1980). By contrast, the Senate Advisory Commission on Intergovernmental Relations concluded state tax differentials do not create a problem in influencing interregional development, finding instead "that powerful economic forces that have been at work for decades underlie much of the continuing interregional redistribution of people, capital, and jobs." ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, INTERSTATE TAX COMPETITION, TAX NOTES 1061 (May 11, 1981).

338. A regulatory incentive might include using the level of participation in the interstate fund as a factor in computing federal revenue sharing portions. *See infra* text at notes 347-54. Tax incentives might include increased depreciation deductions available to projects within participating states, or even a direct tax exempt government subsidy.

339. *See* J. F. HELLIWELL, *supra* note 337, at 17.

ing Act of 1920, but are considerable for Outer Continental Shelf oil and gas drilling rights.[340]

The ability of the Council to survive would be based on its ability to distribute benefits and burdens. All Americans hold a strong claim to the benefits of a publicly-owned resource base; every state shares its burden of interdependence with both energy-producing and energy-importing sister states alike. Enormous and largely unforeseen fiscal pressures have been caused by the radical rise in values of unevenly distributed resources. The ability of the American federalist system to cope with these pressures will almost surely lie in the maintenance of flexibility. Allocation of federal tasks and state revenues to an unprecedented Interstate Council would doubtless be a difficult endeavor.[341] The chief dilemma facing the Council lies in the immensity of the resource revenues themselves — these revenues bring such wealth that they challenge almost any sense of sharing; yet they reveal such disparities that they demand distribution.[342] The success of the proposed Council requires a solid sense of common interest, of committed union, within the context of constitutional federalism.

B. Interstate Lending of Revenues

The second proposal is the provision of low-interest loans to fiscally bankrupt energy-importing areas made available from energy-producing state revenues.[343] A producing state would act in an individual capacity to assist those areas of the country which are

340. The federal government does not share any of the royalty revenues it receives from leasing the Outer Continental Shelf areas. In 1978, the federal government earned over $1 billion in royalty income from offshore development in Louisiana alone. LOUISIANA'S FIRST USE TAX, *supra* note 335, at 196.

341. Some might even say impossible. "The differing tax structures within each state and the varying distributions of functional and financial responsibilities of states, counties, townships and special districts make it impossible to evaluate — across state boundaries — the relative needs of individual districts." FINANCING STATE AND LOCAL GOVERNMENT, PROCEEDINGS OF THE MONETARY CONFERENCE, THE PROBLEM OF REDISTRIBUTION OF FEDERAL AND STATE FUNDS, 79 (1970).

342. J. F. HELLIWELL, *supra* note 337, at 18. Discussing the need for reform in the severance tax area, the Wall Street Journal concluded:

> But to get such an approach through Congress, northeastern politicians would have to display a sensitivity to Sunbelt concerns that at present totally escapes them. As long as they play the issue as another theme in their region-bating, they are going to go through one after another of the crushing defeats that Senator Russell Long knows so well how to administer. No one, North or South, will benefit from the mutual anger that will result.

Coal Severance Tax Hearing, supra note 1, at 106 (citing Wall Street Journal, June 16, 1980).

343. *See Coal Severance Tax Hearing, supra* note 1 at 107 (citing Minneapolis Star, May 12, 1980); *id.* at 94 (citing Washington Post, April 20, 1980).

hardest hit by a recessionary economy evidenced by increased tax burdens, decreased public services, and high unemployment. A state legislature might appropriate annually a certain portion of its resource revenues to be made available as loans to other state or local government entities. Such an income redistribution system would be much more simple to administer than the proposed interstate revenue pool. The risks to the producing states are fewer — no funds are given away, they are merely loaned; repayment would be secured by acceptable collateral;[344] and the need for agreement extends only to the state legislators and not to other states' representatives. The benefits of goodwill and good public relations are potentially substantial both in terms of commerce and political clout.

Fashioned along the lines of the Reconstruction Finance Corporation[345] which was established by Congress in 1932 to provide loans to farmers in financial distress, a small Board could be created by the state legislature. The Board would administer disbursement of loans to those government entities which qualify under legislated guidelines. The lending factors which might be considered include per capita income, current tax efforts, spending programs, and ability to repay.[346] A limitation could be placed on the amount of loans made to any one government, perhaps computed as a percentage of the total funds made available that year. The purpose of the loans would be to provide funding for programs which would stimulate the economy of a depressed region. Such a redistribution of a portion of resource revenues to energy-importing states would ameliorate the disturbing fiscal disparities which have been occasioned by energy resource development.

C. Federal Revenue Sharing Revised

The federal government can also act to reduce the conflict between the energy-producing and energy-importing regions of the country. In 1972, Congress enacted a program of federal fiscal assistance to state and local governments, commonly known as federal revenue sharing.[347] Congress recognized that it is the state and local govern-

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344. Collateral could be provided by a mortgage on property to be used in the proposed project.

345. Pub. L. No. 2, 47 Stat. 5, 15 U.S.C. §§ 601-617 (1932).

346. The purpose of the Reconstruction Finance Corporation was not to provide a "handout" but was to make available loan funds which were in major part repaid. All loans were fully and adequately secured. 75 CONG. REC. H7360-2508 (daily ed. Jan. 22, 1932). *See Commerce Clause Hearings, supra* note 9, at 121 (statement of Charles E. McLure, Jr., Vice-President of the Nat'l Bureau of Economic Research).

347. The Fiscal Assistance to State and Local Governments Act 1972, 31 U.S.C. §§

ments which must bear the brunt of difficult economic problems. The purpose of federal revenue sharing is "to provide the states and localities with a specified portion of federal individual income tax collections to be used by them in accordance with local needs and priorities and without the attachment of strings by the federal government."[348] A similar program could be enacted to address the problem of fiscal strain caused by increased energy costs in an area.

In general, grants from the federal treasury are distributed to the states in proportion to an index computed with five factors.[349] One element is per capita income; the others are population, urbanization, relative use of income taxes, and total tax effort. The lower the per capita income and the greater the population, urbanization, state income tax, and total tax efforts, the larger will be that state's share of federal revenue sharing funds.[350] Tax effort refers to the taxes raised from the state's own sources as a fraction of the total personal income of the state's residents.[351] Severance taxes are included in the tax effort computation.[352] As a result, the energy-producing states' tax efforts reflect large resource revenues; those states are entitled to a larger portion of federal revenue sharing funds.[353] The inequities brought about by this result are patent.

An alternative to the present revenue sharing system would be quite simply to exclude all resource taxes from the sharing computations. By removing the distortion caused by steeply escalating energy values, the resource tax exclusion would equalize the states' positions and limit the states' revenue sources to the more stable tax bases of property, income, and sales taxes for the purposes of computation. A revenue sharing formula which excluded resource taxes would redistribute federal revenues more equitably and would stabilize the economic balance between the states.[354] Furthermore,

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1221-1265 (1976).

348. S. REP. No. 1050, 92d Cong., 2d Sess., *reprinted in* [1972] U.S. CODE CONG. & AD. NEWS 3874.

349. 31 U.S.C. § 1225(b)(3) (1976).

350. *Id; Coal Severance Tax Hearing, supra* note 1, at 103 (citing National Journal, March 22, 1980).

351. FINANCING STATE AND LOCAL GOVERNMENT, PROCEEDINGS OF THE MONETARY CONFERENCE, REVENUE SHARING — A CRITICAL VIEW, 43 (1970).

352. S. REP. No. 1050, 92d Cong., 2d Sess., *reprinted in* [1972] U.S. CODE CONG. & AD. NEWS 3905.

353. Alaska, even though it is giving away money to its residents, has the highest tax burden in the country for federal revenue sharing purposes. *Coal Severance Tax Hearing, supra* note 1, at 106 (citing Wall Street Journal, June 16, 1980).

354. FINANCING STATE AND LOCAL GOVERNMENT, PROCEEDINGS OF THE MONETARY CONFERENCE, REVENUE SHARING — A CRITICAL VIEW, 17-18 (1970).

the contest over the validity of state resource taxes may lessen once the impact of that income is removed from the federal revenue sharing system.

Any one or more of the three proposals presented herein would operate to lessen the conflict between energy-producing and energy-importing states. Admittedly, an Interstate Council would face strong opposition; however, the states may prefer to submit decisions to their sister states where power is wielded among peers rather than to lose control over large revenues to the federal government whose authority is absolute. The possibility that producing states may individually offer loans to qualifying importing states is perhaps more viable. Loans may be more politically attractive to producing states than would be outright gifts. Importing states may nevertheless complain that the loan qualification terms set by lender states operate to coerce decisionmaking processes of the energy-importing states, thereby continuing inequitable distribution on another level. Both proposals — the Interstate Council and the producing state loans — can be effective, but only if each state recognizes its mutual dependence upon its sister states. Surely economic chaos in one state would eventually affect another's resource revenues; just as surely, other states will develop into energy producers as new reserves are explored and the balance will change once more. The final proposal suggesting revision of federal revenue sharing computations to exclude severance tax revenues is the most easily accomplished and is the most strongly recommended.

The three alternatives posited in this article certainly are not the only available means to deal with the intricacies of energy resource taxation. The federalism established by the Constitution is necessarily a flexible structure, capable of expansion and accommodation. Where money is involved — huge amounts of it at that — compromise is not so simply attained. Yet it is here, in the area of resource revenues, that federalism must expand to allow the state legislature its autonomous judgments; specifically it must accommodate the needs of its financially poorer members.

V. Conclusion

Colstrip, Montana is a small American town. It just happens to be located over some of the largest coal reserves in the nation and, because of that, five square miles of nearby land is now a coal strip-mine. Roads have been needed, as well as schools, hospitals, recreation facilities, and housing in order to provide for a new transient population. The Montana state legislature witnessed the direct impacts of coal development on the original residents of Colstrip — it saw the same in many other places. A tax on coal production was imposed to generate the revenues needed to mitigate the adverse effects which coal mining had brought to the state. Certainly, Montana wants its coal to be mined — but it demands that the price of coal paid by the American public reflects the true social, environmental, and future costs which Montana alone must pay.

The constitutional validity of Montana's 30 percent coal severance tax was questioned by the coal producers and their utility company customers in the case of *Commonwealth Edison Company v. Montana*. The United States Supreme Court upheld the state tax. Applying a flexible commerce clause test, the Court examined the practical effects of the tax. It found that the tax was fairly related to the services which were provided by the state and concluded that those who ultimately consume Montana coal may be legitimately required to pay the tax. The Court also upheld the tax under a supremacy clause challenge, finding that no direct conflict existed between the coal severance tax and any federal statutes. While acknowledging the judiciary's inability to determine an appropriate rate of energy resource taxation, the Court left unresolved the question of who should decide the appropriate level of energy resource taxation, the state legislatures or Congress?

A state legislature's function is to balance carefully the competing interests presented for its consideration. It is capable of considering the myriad benefits and costs which directly attend coal development. Each state's treasury has had to pay for the impact assistance needed by small, rural local governments; the environmental monitoring needed to reduce mining's physical damage; and the roads needed to transport the coal produced. The state legislature must examine both the costs incurred by coal development and the existing tax structure before it can develop an equitable revenue-generating measure. Congressional interference in these state determinations would be unwarranted in light of the federal government's role in coal development to date.

The 1973 OPEC oil embargo precipitated the federal government's current encouragement of increased coal consumption. Nonetheless, there is no single federal statute which expressly outlines a comprehensive national coal policy. While some form of a general federal approach can be pieced together from various statutes, such approach recognizes the validity of the state legislatures as promulgators of resource taxes. The implementation of federal policy generally has been unclear and ineffective. The Bureau of Land Management has been inactive as lessor of the federal lands which hold a major portion of western coal reserves; the Internal Revenue Service has been generous as a purveyor of economic benefits to the electric utilities; and the Interstate Commerce Commission has been liberal as regulator of the railroad industry which transports most of the coal produced in the West. These federal agencies have not effectuated any kind of cohesive national coal policy — their actions have tended to increase prices instead. It also appears that federal policies may be responsible for the greater concentration of control of the coal industry exercised by the large utilities, energy companies, and railroads over a previously competitive coal marketplace. Therefore, the federal government's actions in western coal development do not evidence a national coal policy which would warrant interference with present state taxation of energy resources.

In deciding an appropriate rate of coal severance taxation, the state legislature must consider the possible competitive disadvantages which would result from a high tax rate. Even if that rate is apparently high, to the extent that it is acceptable to the marketplace, it will more accurately reflect the socially optimal price of coal than would a federally regulated price. Prices of coal must rise, both to reflect the true market price of an energy resource and to allow the environmental and social costs of production to be internalized. The additional cost of a state's severance tax is slight in relation to the total cost of coal. Further, it is a small cost to ensure that the renewed national emphasis on coal does not result in the costly sacrifice of western lands to strip-mining.

Three alternatives have been proposed as means to reduce the conflict between energy-producing and energy-importing regions of the country. The alternatives are premised on the assumption that a federalist system requires a mutual interdependence among the states. The first proposal would create an Interstate Council into which every state would pool a portion of its surplus resource revenues which would then be disbursed to those states requiring special assistance. The second alternative is patterned after the Reconstruction Finance Corporation and recommends that low-cost financing be made available to those energy-importing localities in difficult financial situations; such lending would be done by the energy-producing states rather than by the federal government. The third alternative concerns reformulation of the present federal revenue sharing computations in order to more equitably reflect each state's need for assistance.

State taxation of energy resources is a troublesome area of both federal and state legislative concern. The energy-producing state governments must demonstrate control over their revenue generating abilities — their energy-importing sister states may refuse to pay the price exacted. The federal government must likewise exercise care in administering its national energy policy, interfering with state taxation decisions only when a clear, cohesive national policy is threatened. The decision of *Commonwealth Edison Company v. Montana* rightly affirms the right of a state to develop a scheme of resource taxation in order to shape — if not ultimately to control — its economic destiny within the federal system.